



## **Microfinance development in Uzbekistan**

TASHKENT 2005

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## **Summary**

This report provides analysis of the current condition of microfinance in Uzbekistan and recommendations on key directions for further development of the microfinance sector. Specific attention is paid to the development of non-government microfinance institutions.

The issues of normative legal framework for microfinance development in Uzbekistan are also emphasized by this report, including the clarification of registration procedures for microfinance institutions, the taxation regime, access to external financial sources, and so on.

This report also highlights issues related to the demand for microfinance services: the main trends which will influence microfinance development in the nearest future, a description of customer categories to ensure the client base of microfinance institutions, and a quantitative assessment of demand for microfinance services.

This report includes recommendations for the further promotion of microfinance development in Uzbekistan, in particular regarding the draft resolution of the Cabinet of Ministers. The implementation of our set of elaborated recommendations would allow the expansion of microfinance services and make microfinance one of the most effective tools for solving socio-economic problems.

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## **List of Abbreviations**

CM	Cabinet of Ministers
GDP	Gross Domestic Product
MFI	Microfinance Institution
MFO	Microfinance Organization
CU	Credit Union
NGO-MFO	Non-Government, Non-Profit Microfinance Organization
ADB	Asian Development Bank
EBRD	European Bank for Reconstruction and Development
CAMFA	Central Asian Microfinance Alliance
BWAK	Business Women's Association of Karakalpakistan
KRBI	Karakalpak Republican Business Incubator
IFC	International Finance Corporation
UNDP	United Nations Development Programme
USAID	U.S. Agency for International Development
JSC	Joint-Stock Company
LLC	Limited Liability Company
CC	Civil Code
NICI	National Institute of Credit Information
ICB	Interbank Credit Bureau
WF	Wage Fund
EF	Employment Fund
AC	Authorized Capital

## **Introduction**

Ensuring the rapid development of the private sector, increasing the private sector's share in the country's economy, and expanding and enhancing small businesses were identified as priorities in the implementation of economic reforms in the address of the President in the joint meeting of the Legislative Chamber and the Senate of the Oliy Majlis on January 28, 2005. The expansion of microcredit is viewed as a tool for the implementation of these priorities.

The declaration of 2005 as the International Year of Microfinance reinforces the special status of microfinance on a nationwide scale, clearly demonstrated by the creation of the [microfinance.uz](http://microfinance.uz) informational website.

Although MFIs show strong growth dynamics, the sector is in its initial stage of development in Uzbekistan and can not yet fully realize its potential. Microfinance so far has not enjoyed wide-scale development in Uzbekistan. Microcredits (microloans) and microleasing (to an insignificant extent) have dominated among the alternative services of microfinance<sup>1</sup>. Yet it should be acknowledged that microcredit involving 70,000 clients is the most viable opportunity for a significant portion of Uzbekistan's population to improve their socioeconomic status. Entrepreneurs involved in microcredit programmes employ 2-3 family members on average, which is essential in the context of the existing employment issues and demographic situation in Uzbekistan. A sociological survey held within research has shown that of those entrepreneurs creating new jobs using microcredits, 81% are clients of MFIs and CUs.

In encouraging the process of microfinance, it is important to address the issues of employment and poverty and the expansion of entrepreneurship can hardly be overestimated. In the meantime, it reduces the appeal of other informal alternative microfinance schemes in Central Asian countries.

Actions intended to encourage the further development of microfinance primarily focus on the development of legal and regulatory framework. Although some components of microfinance have existed in Uzbekistan for 7 years, their legal framework has been developed unevenly: given the full package of regulations for microcredit by commercial banks, there is no legal or regulatory framework for microcredit by NGOs-MFOs. The legal framework of microinsurance, microleasing, and microsavings has not been developed either.

Another major issue is the lack of clear legal status and registration procedures for various types of MFIs. Issues surrounding the taxation of microfinance institutions and their access to external sources of borrowing require special attention.

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<sup>1</sup> Microfinance includes the following components: microcredit, microsavings, microinsurance, microleasing, provision of consulting services, and money wires.

There are a number of other technical issues related to reporting, human resources, information components, financial viability, cash transactions, introduction of new microfinance products, the coordination of efforts, and the targeted and effective use of microcredit resources.

**Study objective** – Analyze the current state of microfinance in Uzbekistan and develop proposals for its further development.

**Research methodology** – Economic analysis methods and sociological survey<sup>2</sup>. Materials from the Central Bank, Ministry of Labor and Public Welfare, IFC, ADB, World Bank, Central Asian Microfinance Alliance, and operational data of commercial banks provided input to the study. Data from the Microfinance Center of Central and Eastern Europe and CIS countries and analytical reviews of the World Bank were used for cross country comparisons.

### **Practical results of the study**

- Materials about microfinance in Uzbekistan have been systematized;
- Analysis of the work and problematic issues of all MFIs have been presented;
- Registration procedures for various types of MFOs (with or without the right to accept deposits from the population) has been proposed in the form of a draft resolution to the Cabinet of Ministers “On the Measures for Further Development of Microfinance in the Republic of Uzbekistan”;
- The main methodical components of the Law “On Microfinance in the Republic of Uzbekistan” have been presented;
- Assessment of the demand for microfinance resources in Uzbekistan has been conducted.

## **1. The Role, Significance and Specific Nature of Microfinance**

**Microfinance** – the process of providing low-income people<sup>3</sup> an access to financing for the purposes of establishment and development of microbusiness. In the context of achieving the UN Millennium Declaration<sup>4</sup> Goals, microfinance facilitates the development of the following processes:

- Meeting the essential needs of low-income groups and protecting them from risks;
- Expanding entrepreneurship, including private and household businesses;
- Promoting gender equality by empowering women to participate in economic activities;
- Investing in the production potential of local communities;
- Reducing poverty and inequality, enhancing social and human development<sup>5</sup>;

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<sup>2</sup> The main objective of this component was to get extensive information on the needs of entrepreneurship in MFO services as well as a general assessment of sector potential, including analysis of its needs and limitations on further development.

<sup>3</sup> Low income persons (vulnerable groups), who are active in economic sense and are capable of engaging in appropriate activities but are not able to do so due to the lack of funds.

<sup>4</sup> It relates to Goal 1 “Eliminating poverty and hunger”.

<sup>5</sup> Access to financial resources enables poor families to create sound business, thereby increasing their income, ensuring their information security, and their children’s education; Secondly, it reduces the vulnerability at the time of a breadwinner’s ailment, adverse weather, partial loss of property, and other shock situations; Employment will increase and unemployment will subside; People will have hopes for better future, which will grow into confidence in tomorrow as businesses develop further; Access to financial resources prevents the transformation of poor groups into the poorest groups with all the related socioeconomic and psychological implications; It contributes to the closure of the economic gap between urban and rural areas.



- Involving poor persons in economic processes;
- Creating of new jobs;
- Establishing new segments of the financial market.

The role of microfinance in the modern world of financial services has been reinforced by World Bank surveys: there are more than 10,000 MFIs in the world, catering to more than 500 million. poor people in developing countries. The assets of these organizations are estimated to total USD 2.5 billion.

Initial efforts to provide financial services to low-income population groups were linked to the end use of these services. In the 1950s-70s government agencies and donor organizations provided subsidized agricultural loans to small-scale and low-income farmers with hopes of increasing their productivity and incomes. In the 1980s-90s microcredits were issued primarily in the form of loans for low-income entrepreneurs for the purchase and accumulation of assets which would enhance their income and welfare. A significant group of recipients was comprised of women, for whom microcredit turned out to be particularly effective.

The development of services, methods, and organizational structure have led to the emergence of financial organizations specialized in servicing the poor. These organizations were named microfinance organizations (MFO)s. They are ‘micro’ because amount of transaction is relatively small (loans in the amount of USD 50 and deposits in the amount of USD 5).

The concept of microfinance penetrated the countries of Central Asia in the mid 1990s, much later than in other regions. Like in other parts of the developing world, the market for microfinance services in the region is rapidly growing. Annually the regional microfinance loan portfolio and number of clients is increasing by 40 percent and 20-30 percent, respectively. Microfinance markets of Central Asia have just started to form – market penetration is insignificant and increasing the population’s savings has not yet started (except for mandatory savings within group crediting programs).

<b>Panel 1. Comparative indicators of microfinance trends</b>	
<i>Europe and Central Asia (September 2001)</i>	<i>Central Asia (December 2002)</i>
<ul style="list-style-type: none"> <li>• Loans in the total amount of USD 800 million have been provided;</li> <li>• The portfolio of microfinance services is increasing by 54% annually;</li> <li>• Number of users of services is increasing by 30% annually;</li> <li>• 1.7 million borrowers;</li> <li>• 2.4 million depositors;</li> <li>• Total amount of deposits – USD 674 million</li> </ul>	<ul style="list-style-type: none"> <li>• Loans in the total amount of USD 200 million have been provided;</li> <li>• The portfolio of microfinance services is increasing by 40% annually;</li> <li>• Number of users of services is increasing by 20-30% annually;</li> <li>• 200,000 borrowers;</li> <li>• No mobilization of savings except for funds of mandatory insurance.</li> </ul>

*Source: CGAP 2003*

Microfinance facilitates the sustainable development of small businesses and the expansion of individual entrepreneurship. Thanks to its accessibility, microfinance is increasing the involvement of the population in small businesses by increasing access to financing and it facilitates the evolution of microbusinesses into medium business. As a rule, microfinance results in an increase in the welfare of the population, a reduction in social inequality, new opportunities for self-realization, and the creation of a developed group of proprietors. The greater the flexibility and receptivity of MFIs to innovations in the market of financial services, the higher the quality of services provided.

As a new financial institution, microfinance contributes to the enhancement and growth of the financial system as a whole, and it facilitates growth and diversification in the savings and loan markets. Microfinance is regarded as a mechanism for establishing a credit history for subsequent bank loans. The issues of cost recovery and financial stability of MFIs is under special focus as microfinance may be and often is a business bearing revenue for the founders and ensuring the employment of borrowers.

Microfinance is particularly effective as an instrument to increase employment and combat poverty. Access to financial services increases the opportunities for people to realize their entrepreneurial potential. Microfinance is also a means to enhance the transparency of the economy and business: practice has shown that MFIs' development reduces the informal credit sector, and the receipt of financial services enhances the transparency of the recipient.

**Panel 2. Success stories of microfinance programmes**

**In the context of poverty.** Enterprises involved in credit projects accounted for 1/8 of economic growth in Indonesia in late 1980s. In 1990s micro enterprises were the most dynamically developing sector of the national economy in Bolivia. In Bangladesh programmes of Grameen Bank for microcrediting were acknowledged as having macroeconomic significance (48% of poorest families who got access to microcredit succeeded in rising above the poverty line). Overall 5 percent of Grameen Bank's clients broke out of poverty annually by participating in microfinance programs. Families also have the opportunity to sustain the results achieved. In India 3 out of 4 clients who were involved in an MFO programme for a substantial period succeeded in significantly improving their welfare. Half of the clients broke out of poverty.

**In the context of improving education.** Among children aged 11-14 the indicator of basic reading, writing, and math skills has doubled from 12 percent to 24 percent in the families which received small loans from the Committee for Rural Development (BRAC). In Honduras clients who received small loans from the Save the Children Association increased their incomes, which enabled them to send their children to school.

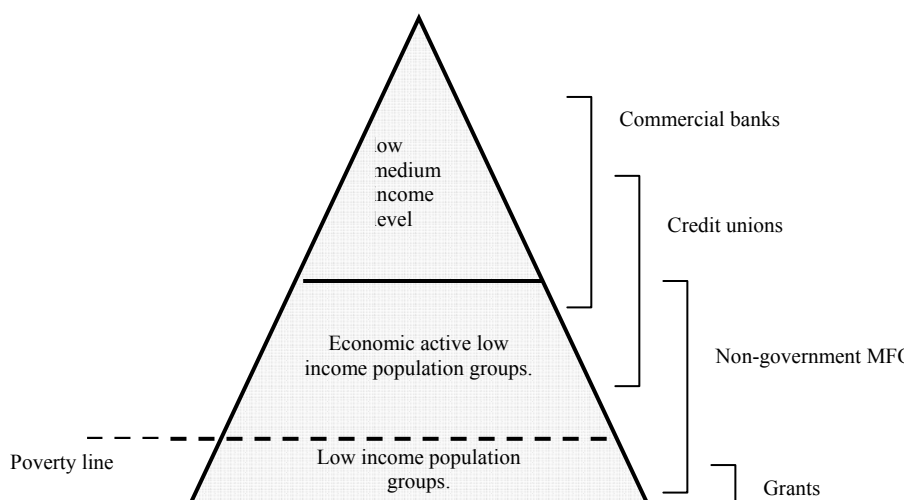
**In the context of healthcare.** Within the framework of its microfinance programme in Uganda, 95 percent of the Fund for Credit and Public Support's clients succeeded in improving the healthcare and nutrition of their children. Likewise, 32% of clients used at least one method of AIDS prevention (in comparison with 18 percent among non-clients). Fewer number of BRAC clients in Bangladesh suffer from malnutrition in comparison with the rest of population and indicators of malnutrition are also reduced by programme membership.

**In the context of gender equality.** Within the framework of Women's Empowerment programme in Nepal, it was established that 68 percent of its participants make decisions regarding the management of their property, family planning, the education of their daughters, and the marriage of their children. In Bolivia and Ghana women's participation in microfinance programmes has led to the enhancement of their status within the community. Participants from Ghana take an active role in conducting community ceremonies whereas participants from Bolivia are actively involved in local self-governance.

**Examples of MFOs activity in Uzbekistan.** In 2000-2001 many farmers had problems with access to irrigation water as priority for water distribution was given to shirkat lands. Some MFOs started providing microcredits for the installation of pumps, which addressed the water supply issue and reduced risks for farmers.

**Specific features of microfinance**

**Figure 1. MFOs and the poverty line** (Source: CGAP, 2003)



The specific features of the microfinance process in Uzbekistan with closely affiliated categories of small business support programs, bank loans to small businesses and social benefits are particularly notable.

Although microfinance is aimed towards the development of entrepreneurship, its distinction from support programmes for small businesses is that NGO-MFOs do not provide preferential loans. In the meantime NGO-MFOs differ from banks in that they extend a small amount of loans and that, as a rule, they do not require collateral.<sup>6</sup>

Microfinance is not a social program. It is not meant to provide social benefits to extremely poor population groups without a permanent source of income (e.g. the homeless or destitute). Its purpose is to offer a small external financial impetus in order to further enable those who are capable of making revenues.

Microfinance is also distinct because of the nature of its transactions. Microfinance has a small scale of loans and deposits; it is orientated towards certain targeted social groups; it uses simple procedures for the assessment and approval of applications; it provides services in the area closest to the client; it offers quick loan disbursement and a strategy of repayment; it encourages loan repayment by offering the opportunity for subsequent larger loans; and it develops services targeted to the specific circumstances and needs of its clientele.

## **2. Analysis of microfinance development in Uzbekistan**

### **Sector Background**

The microcredit programme was initiated in 1998 with two UNDP pilot projects in Kashkadarya and Karakalpakistan. The projects have supported the establishment of three NGO-MFOs and their implementation laid the foundation for national legislation adopted in August 2002 (Resolution # 309 of the Cabinet of Ministers). Principle outcomes of the pilot projects included a tangible increase in low income people's access to financial resources which enabled them to participate in trade and small scale production, manage household assets based upon microbusinesses, livestock tending, and service provision.

Microfinance in Uzbekistan is currently conducted by commercial banks, credit unions (CU), non-government non-profit (donor) organizations (NGO-MFO) as well as off-budget funds (Funds for Farmer Support, State Employment Fund) and credit lines of the international financial institutions (EBRD, ADB, etc.). Banks have a leading role in microfinance – they account for more than 80 percent of the total amount of microcredits.

General features of microfinance development in Uzbekistan include:

- **Target group.** Two groups – traders and agricultural producers – visibly stand out among the microcredit recipients of all types of MFIs.
- **Amount of microcredit and interest rate.** The average amount of a bank loan is 3 times the size of a CU loan and 16 times the size of an MFO loan. Although their repayment periods are shorter, the most expensive loans are those of CUs. Therefore,

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<sup>6</sup> Usually traditional financial intermediaries such as commercial banks do not serve low-income families due to the high cost of small transactions, lack of traditional collateral, geographic isolation, high risk, and sometimes, due to social prejudice.

although CU loans are free of a number of flaws typical to banks<sup>7</sup>, they are not designed for low income borrowers. NGO-MFO loans are more appealing to low income borrowers due to their simplified procedures and relatively low cost.

- **Borrower expenditures.** The repayment of bank loans is comparable to tax payments in Uzbekistan and amounts to 12.6 percent of the borrowers' expenditures. CU clients pay 8.7 percent of total business expenditures for debt servicing, while MFO participants pay 3.3 percent.
- **Effectiveness.** Surveys have shown that non-bank loans contribute to the sustainability and yield of microbusinesses in a more effective manner. MFO clients feel the most positive changes: 71 percent of MFO clients have increased their turnover and 60 percent increased their profits. Microcredits yield the most tangible effect on growth in turnover and profit in trade, production of foodstuffs, and catering services. They are less effective in the sectors such as growing agricultural crops and services sector.

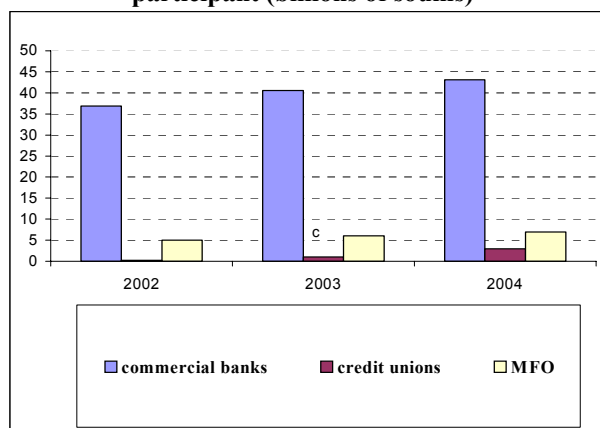
**General problems of microfinance include:**

**Legislation.** The lack of legal framework for MFOs and the concept of the microfinance market development is the greatest factor hindering development. Although some components of microfinance have existed in Uzbekistan for 7 years, their legal framework is not uniform as seen in the following criteria.

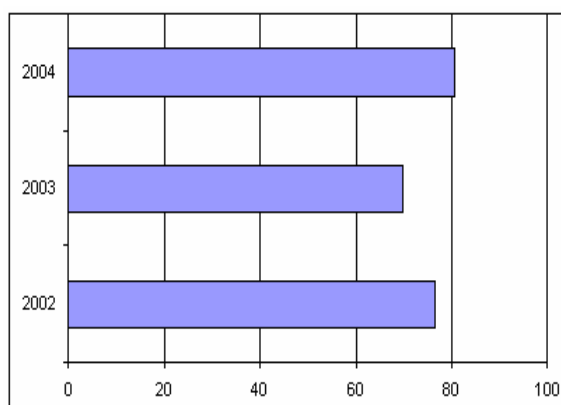
*Types of organizations.* While there is a full package of regulations on microcredit through commercial banks and a law on CUs, the legislative and regulatory framework for microcredit operations by NGO-MFOs is missing.

*Types of activities.* Given the relatively developed legislative and regulatory framework for microcrediting, there is no legal framework for microinsurance, microleasing, and microsavings.

**Fig. 2 Composition of microcredits by type of market participant (billions of soums)**



**Fig. 3. Share of own banking resources in the total volume of banking microcredits, %**



Source: Author's calculations.

**Institutional.** The lack of legislative and regulatory framework<sup>8</sup> and official legal status prohibits NGO-MFOs (the most 'social' institutions in microfinance) from borrowing capital from external sources (loans from commercial banks and individual deposits), and thus limits their lending capacity.

<sup>7</sup> See, Table 9, Annex 1.

<sup>8</sup> Except basic Resolution # 309 of the Cabinet of Ministers "On actions to develop microfinance in the Republic of Uzbekistan" adopted on August 30, 2002.

**Economic.** There is no official distinction between cash and non-cash money in Uzbekistan. But in practice one's ability to withdraw cash from a bank account is limited due to cash shortages. Due to the nature of their activities, all types of MFOs suffer from this problem.

The analysis has shown that there are currently no microcredit products available which are able to ensure financial sustainability for all MFIs. The main reason for this is the relatively high level of transaction costs, which can reach as high as approximately 20-25 percent of the loan portfolio. On the other hand, there are no clearly developed unified criteria for the assessment of MFI financial sustainability and their social impact.

**Information.** The primary informational demand of potential clients is for information about the organizations providing microcredits. Clients' secondary demand is for assistance in completing the requisite paperwork. Assistance in paperwork is the second.

The consolidation of information about all institutions which provide microfinance services is a more wide scale problem. Bad borrowers are winners in the current situation due to the highly fractured availability of credit history information.

**Macroeconomic implications of the abovementioned problems:**

- **Low level of outreach depth.** The average estimated outreach depth is 9 percent.<sup>9</sup> In comparison, advanced MFOs in the Eastern European countries undergoing reforms have achieved an indicator of 20-25 percent.
- **Low level of outreach to low-income populations.** This indicator is estimated to be 0.6%,<sup>10</sup> which is substantially lower even than the average regional level which is estimated to be 2%.

**Table 1. Assessment of the current potential of microfinance in Uzbekistan**

Indicators	2003	2004
Total amount of microcredits of all types of MFIs/ GDP, %	0,65	0,71 <sup>11</sup>
- microcredits of commercial banks to GDP, %	0,42	0,35
- employment generation Fund microcredits to GDP, %	0,0	0,0
- EBRD microcredits to GDP, %	0,2	0,3
- NGO - MFOs microcredits to GDP, %	-	0,04
- CU microcredits to GDP, %	0,03	0,02
Commercial bank microcredits / Total amount of bank loans in real sector of the economy, %		1,2
Microcredits of all types of MFIs / Total volume of bank – credits into the real sector of the economy, %		2,4

Source: authors' estimates

**2.1. Activities of non-government non-profit microfinance organizations**

Currently 14 NGO-MFOs are operating in Uzbekistan including:

<sup>9</sup> Average outreach depth is calculated by comparing the average loan amount to GNP per capita. According to the CAMFA's data on 11 large MFOs in Uzbekistan, the average loan amount stood at USD 146. According to World Bank data, the estimated GNP per capita of Uzbekistan in purchasing power parity stood at USD 1,720 in 2003.

<sup>10</sup> Measured as the ratio of total number of MFO clients to the number of poor population. According to World Bank data, the number of people below the poverty line was estimated to be at 27.5% of total population (25.6 million in 2003).

<sup>11</sup> For instance, the NGO-MFO loan portfolio is approximately USD 30 million or 1.8% of GDP in Kyrgyzstan. In Kazakhstan this indicator is equal to USD 5 million or 0.02% of GDP, while in Tajikistan it makes up approximately USD 3 million, or 0.2% of GDP (2002 data).

- organizations, for whom microfinance is not main activity (e.g. Business Women's Association);
- local organizations registered in accordance with the legislation for whom microfinance is the main objective (e.g. Daulet NGO);
- programmes and projects of international organizations not registered as entities in Uzbekistan (e.g. Barokot, acting within the Netherlands' Mercy Corps project).

The rate of growth in the volume of transactions and number of clients illustrates the overall market trend. While the loan portfolio of 9 NGO-MFOs was equal to USD 2.53 million as of October 1 2004, it amounted to USD 3.9 million in May 2005. Since the beginning of microfinance in Uzbekistan, the total number of NGO-MFO clients has reached nearly 41,000, and number of active clients is approximately 25,000.

Borrowers have been issued more than 10,300 loans, of which 97 percent did not exceed USD 500 and only 1% equaled USD 1,000.  $\frac{3}{4}$  of all loans were provided for a period of up to 3 months, of which slightly more than a half were given for up to one month. Survey results have shown that 75 percent of the borrowers who applied for loans were not first time applicants, only 25 percent were newcomers.

Characteristics of the NGO-MFO activities in Uzbekistan are:

- Female clients (up to 70%) mainly with secondary education and involved in farming, trade or services;
- Household based production by borrowers and the broad use of unpaid labor by family members;
- Consistent programmes and policies of all NGO-MFOs, demonstrated by identical procedures for submitting and reviewing applications and disbursing loans;
- High repayment rate of microloans exceeding 96 percent;
- Demand for microfinance services significantly exceeds the supply, which implies existing interest rates are excessive and rigid;
- high transaction costs;
- relatively small maximum amount of loan (500,000 -600,000 soums). What is more, this loan can be received only after 1-1.5 years of participation in the programme. During the first year loan amount does not exceed 100,000 soums.
- The average MFO client has more than 500,000 soums of turnover per month (persons with less than average monthly turnover cannot stay in MFO programs).

### **Leasing transactions**

In August 2002 Presidential Decree "On actions for further encouragement of leasing activities" was issued, which removed the tax barriers hindering the development of the leasing sector and offered the same terms of taxation along with other financing schemes, particularly bank loans. In 2002-2003 Parliament adopted more than 40 amendments to the Civil Code, Tax Code, Economic Procedural Codes, and laws "On leasing" and "Customs tariffs". This has led to the creation of a progressive legislative atmosphere which encourages the development of this type of financing.

Thanks to these efforts, new players<sup>12</sup> emerged in the market, lowering Uzselkhoz mashleasing's share. While it amounted to 93% in 2001 and 84% in 2002, it stood

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<sup>12</sup> Up to 2002, 13 lessors were undertaking lease deals, as of end 2004 their number reached 28: 15 commercial banks, 11 leasing companies and 2 MFOs.

at 64% in 2004<sup>13</sup>. Two MFOs appeared among the new market players: the Karakalpak Republican Business Incubator and the Association of Business Women of Karakalpakistan, who provide microleasing services in the framework of an ADB pilot project entitled “Innovative methods of poverty reduction in Karakalpakistan”.

The maximum lease amount in the framework of the ADB project is USD 10,000. But in practice, the scale of the projects significantly varies. As of May 29, 2005, 52 KRBI projects worth a total of USD 160,000 and 56 BWAU projects worth a total of USD 110,000 were disbursed.

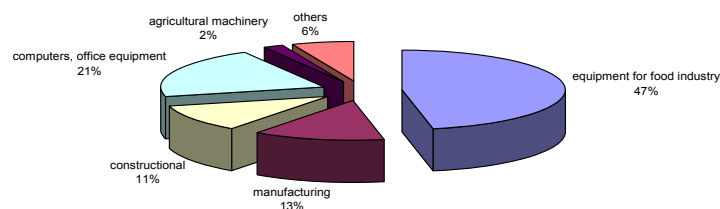
**Panel 3. Indicators of MFO leasing deals in the framework of ADB pilot project**

<i>Indicators</i>	<b>BWAK</b>		<b>KRBI</b>	
	<b>2003</b>	<b>2004</b>	<b>2003</b>	<b>2004</b>
Number of lease agreements per annum	27	26	31	16
Total amount of the leasing agreements made per annum (at the cost of property bought for leasing) <i>thousands of USD</i>	55,0	55,1	55,2	83,1
Total cost of the property turned over for leasing per annum, <i>thousands of USD</i>	47,4	55,1	55,3	83,1
Number of leasing deals in the portfolio at the year end ( <i>number of active lease agreements</i> )	25	51	31	47
Leasing portfolio (remaining amount of principal by the active lease agreements) as of year end, <i>thousands of USD</i>	48,0	96,3	54,7	132,2
Cost of property turned over for leasing in accordance with credit policy, <i>thousands of USD</i>				
-minimum	-	-	-	-
- maximum	10,0	10,0	10,0	10,0
Minimum cost for property leased, <i>thousands of USD</i>	0,7	0,6	0,2	0,7
Maximum cost for property leased, <i>thousands of USD</i>	8,6	9,6	10,0	9,7
Average amount of lease agreement (based on the cost of property leased) <i>thousands of USD</i>	1,9	2,1	1,8	5,2
Lease period for the property specified by the lesser (according to the credit policy)	3 years	3 years	3 years	3 years
Average term for lease agreements made	3 years	3 years	3 years	3 years

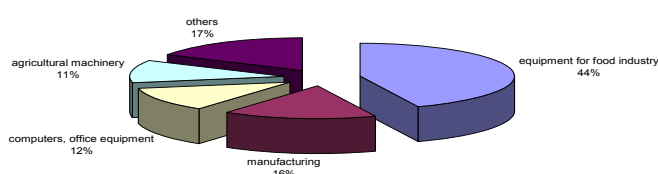
*Source: Annual report by IFC “Leasing in Central Asia -2005”*

**Figure 4. Types of property provided for leasing in 2003-2004**

**Association of Business Women of Karakalpakistan**



<sup>13</sup> IFC data.



Source: Annual report by IFC “Leasing in Central Asia – 2005”.

The government encourages NGO-MFOs activities: they are exempt from income(profit) tax until January 1, 2006, provided they use those funds to cover operational costs, develop their own logistical infrastructure, and fund further microfinancing.

### **The problems related to the functioning of NGO-MFOs:**

- **Lack of formal legal status.** It is impossible to attract the population’s deposits and bank credits without such a status. Therefore, despite the fact that cost of loan funds is equal to zero or nearly zero, interest from income and donor grants are the main sources of loan capital. It is also a reason for high interest rate.

In the meantime, despite the semi-legality of their existence, microcredits on the part of international organizations and donors have already involved more than 40,000 clients, thus demonstrating the significant potential of this process, were it to gain full legitimacy.

- **Registration procedure.** Lack of transparency in registration procedures hinders the growth in a number of NGO-MFOs and also the overall development of a competitive environment in this segment. Registration in the form of NGOs is not appropriate as it creates many legal contradictions. The notification form of registration is preferable, particularly for those MFOs which do not accept individual deposits. It is also essential to develop legislative framework which defines procedures for the registration of branches and local offices of MFOs, which should also be made on notification basis.

- **Coordination of efforts.** Due to the small number of MFOs, there is no coordination of their efforts to focus their resources into tense socioeconomic areas. But due to the sector’s increasingly competitive environment and growth in the number of MFOs, the coordination of actions and the consolidation of their efforts to provide microfinance services will become crucial to ensure effective operations.

The Ministry of Labor and Social Welfare is currently developing the concept for the creation of the Social Investment Fund in Uzbekistan which endeavors to ensure the consolidation of efforts, coordination, and diversity in microfinance services. The principal feature of this Fund is envisioned as the partial re-allocation of commercial banks’ credit lines to the credit lines of this Fund.

- **Maximum risk level.** In comparison with similar activities of other institutions such as banks and CUs, microcrediting by NGO-MFO is the riskiest. The majority of loans are provided without collateral. Additionally, all of the microbusinesses in which clients engage are risky. This is particularly true for livestock farming, where price fluctuations are more significant, many inputs are required in the initial stage and turnover is much slower.



Businesses with high profit margins and small turnovers are extremely susceptible to market fluctuations. Even the smallest reduction in profit margins results in businesses losing money. Agriculture is particularly susceptible to such risks, and those loans are a constant threat to the financial sustainability of MFOs. Although MFOs are trying to stabilize the effect of the loan<sup>14</sup>, professional risk assessments of the local markets are not conducted.

- **Reporting.** Traditional forms of reporting are not suitable for NGO-MFOs as they are too cumbersome. Nevertheless, there is a clear need to push for systematization and information transparency in NGO-MFOs by developing simplified forms of reporting adapted to the particular features of MFOs' activities.

Currently some NGO-MFOs are utilizing methods developed with the assistance of CAMFA for filing consolidated reports on current loan flows and for creating financial projections based on uniform standards. Local NGO-MFOs (Daulet, Sabr, and BWA of Karakalpakstan and Kashkadarya region) have accumulated solid practical experience in training professionals of microfinance programmes for poor population groups. However, in terms of methodology, the distribution of labor, and financial expenditures, the overall internal calculations, monitoring, and assessment of MFOs are not optimal.

- **Inadequate staff capacity.** This is a completely new and specific dimension. There are no experienced staff, and the need for staff training and the creation of training materials and guidelines (especially in Uzbek) is acute. Staff members are not yet competent to create new credit products independently or to effectively adapt borrowed products, particularly those aimed at the creation of sustainable sources of income in rural areas.

- **Audit.** Conducting audits of NGO-MFOs is hindered by high costs and underdeveloped audit institutions. Uzbek law must provide for mandatory audit procedures for NGO-MFOs and determine the list of independent organizations authorized to conduct those audits in the future. Audits by the government body which registers and supervises MFOs are not permissible.

## 2.2. Microfinance services of commercial banks.

Microfinance services of commercial banks consist of two components:

- Offering microcredits from bank's own sources;
- Servicing microcredit lines of non-budgetary funds and international credit lines.

### Commercial bank microcrediting from own resources

In accordance with Central Bank guidelines, microcredits in local or foreign currency equivalent to USD 10,000<sup>15</sup> can be issued for up to 3 years to farmers and other small businesses, who initiate by forming a legal entity. Microcredits are issued only to residents with deposit accounts at the Central Bank. Loans are not permitted to be issued to clients of other banks.<sup>16</sup>

Cash loans can be issued up to 50% of the microcredit amount to farmers for the purchase of cattle, birds, seeds, and saplings for up to 18 months. Interest rates for microcredits are set in accordance with the loan agreement but not higher than Central Bank rate.

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<sup>14</sup> First method – deposit the loan into another business unrelated to business-plan. Second method – one person in the group handles the microcredit by agreement with other group members.

<sup>15</sup> By Central Bank's exchange rate on the day of loan issuance.

<sup>16</sup> The list of all microcredit products offered by Uzbek commercial banks is given in the Table 19 of Annex 1.

Microcredits are provided to borrowers for the following purposes:

- Purchase of mini equipment;
- Development and expansion of one's own production line including the purchase of seeds, cattle, calves, lambs, birds, forage and mixed fodder, veterinary drugs, plant chemicals, mineral fertilizers;
- Primary processing of raw materials;
- Purchase of job instruments, raw materials, semi-finished products, accessories;
- Production of art, crafts and applied art works;
- Development of craftsmanship, the establishment of household-based work;
- Development of the services sector and the provision of consumer services;
- Healthcare development;
- Development of the tourism industry;
- Establishment of small-scale production;
- Other types of entrepreneurial activities related to the manufacturing of consumer goods and the services sector not prohibited by law.

Microcredits cannot be issued for following purposes:

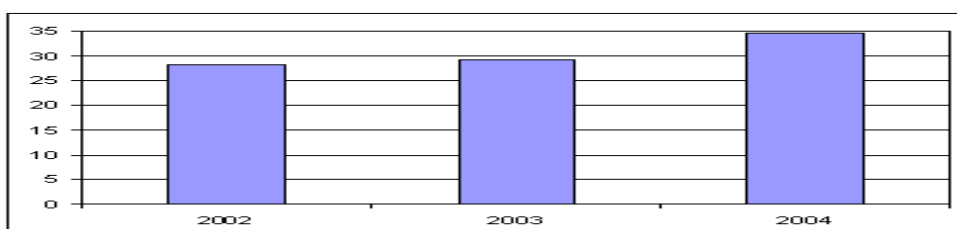
- Repayment of earlier borrowing or any other debts;
- Tobacco growing and production of alcoholic beverages;
- Trade and middleman ship;
- Purchase of private property unused for business purposes.

Loan periods vary from 1 year (to boost working capital) up to 5 years (for investment projects financed from the bank's Fund for Preferential Crediting).

The procedure for issuing microcredits is the same except that the maximum amount is USD 5,000.

Preferential interest rates are set for microcredits to encourage small businesses and private entrepreneurship: not higher than 50 percent of the current refinancing rate, if the funds are disbursed from the Fund for Preferential Crediting, formed by 25 percent deductions from bank's profits. Meanwhile, the banks are granted tax benefits for revenues derived from crediting small businesses and funds allotted to increase the loan portfolio for microcredits.

**Figure 5. Volume of microcredits issued by own resources of commercial banks, *billions of soums***



*Source: Author's calculations*

**Problems in microcredit by commercial banks are as follows:**

- **Microcrediting losses.** Banks are not interested in microcrediting due to high transaction costs and the high risk of microcredit transactions. Preferential interest rates imply the loss making nature of these loans as they contradict the basic commercial nature of the banks.
- **Limitations.** Banks issue microcredits mainly for the establishment of production. Nevertheless, it is virtually impossible to start a manufacturing business in the 2-3 years of loan period unless this business is trade. Furthermore, existing limitations on receiving the entire amount of microcredits in cash are not appropriate in the case of small amounts.
- **Collateral.** There are a number of issues related to the collateral of bank microcredits. They include: the inability to sell the collateral without client's consent; the lack of clear procedures for the confiscation and transfer of collateral; issues of notary certification of collateral; issues of objectivity in assessment of collateral, the incapacity of insurance companies to act as an insurance guarantor; the high cost of legalizing collateral<sup>17</sup>; disputed issues of collateral taxation<sup>18</sup>; the storage of some types of collateral<sup>19</sup>; and issues of guarantee<sup>20</sup>.
- **Loan indebtedness.** All types of bank microcredits are risk-prone as all manufacturers encounter marketing issues and high taxation. Failure to repay loans is not a banking issue but an issue of proper encouragement of small business development and nationwide entrepreneurship.

On the other hand, bank employees note that microcredits in amounts between 5 million and 10 million soums are excessive. Many clients overestimate their capacity to repay and do not have sufficient skills to manage their capital.

### 2.3. Microfinance services of credit unions.

In order to expand financing capacity in remote areas of the country, to raise funds through deposits, and to promote competition among credit organizations, Law # 355-II of the Republic of Uzbekistan "On credit unions" was adopted on April 4, 2002. Currently there are 20 CUs operating under government-issued licenses. They can be divided into three categories based on the size of their assets: large (with assets over 500 million soums), medium (100-500 million soums), and small (less than 100 million soums).

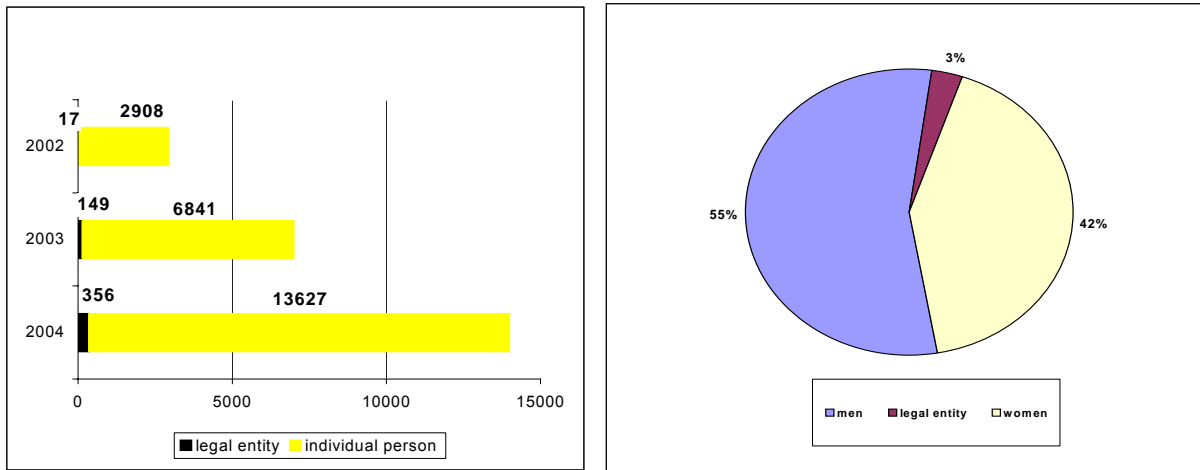
**Figure 6. Growth in CU membership in 2002-2004. Figure 7. Composition of CU loans by the types of borrowers**

<sup>17</sup> For a loan of 1 million soums, the value of collateral must be no less than 1.2 million soums. Independent experts charge 10,000 soums for an assessment of collateral. Insurance agency charges 0.5% of collateral value – 6,000 soums. Notary charges state fee at the amount of 0.15% of collateral value – 1,800 soums, plus the service fees of the notary – 5,000 soums. As a result, the farmer must spend 22,800 soums to get a loan (survey materials).

<sup>18</sup> When a bank accepts collateral onto its balance sheet, it is levied a 20% VAT. According to the law, the bank must sell the equipment in auction after the decision of the court. However, in practice the sale of collateral is a "hurdle" for banks without any end profit. Banks do not accept jewelry as collateral because the procedure for getting a license for jewelry is extremely complicated. Assessment and special premises will be required.

<sup>19</sup> Analysis has revealed that vehicles are the most popular form of collateral. However, banks do not have special car storage facilities and parking payments create additional expenses.

<sup>20</sup> Guarantees create additional difficulties. Banks must analyze not only the financial state of the borrower but also of the guarantor. Only financially stable organizations can be guarantors but there is no list of these organizations. Practice has shown that insurance companies are not reliable guarantors and guarantees of mahalla (neighborhood) committees have no real significance as they are not backed up by actual property.



Source: WOCCU Seminar materials, May 2005, Tashkent.

Based on the dynamics of their membership, 2004 can be named the Year of Credit Unions: while there were little fewer than 3,000 persons involved in CUs at the beginning of the year, more than 14,000 persons were involved by late 2004. The number of legal entities represented by small and private businesses is also on the rise. One particular feature of CU's operations in Uzbekistan is a predominance of individuals, which make up more than 97% of the client's structure). The number of legal entities, consisting primarily of small and private businesses, is also on the rise.

The main financial indicators of CUs are undergoing even faster change. Total assets of CUs currently exceed USD 4.2 million<sup>21</sup>, whereas loan shares stand at a relatively high level of 82% thereby meeting international norms. Meanwhile, CUs are very active in issuing credits: the amount of microcredits issued to all categories of borrowers increased by 300% between January 1, 2004 and January 1, 2005, rising to a total of 3 billion soums.

CU efforts to mobilize the savings of their members have also seen a boost. Total deposits grew by 3.5 times in 2004 only. The growth rate of deposits corresponded to (and sometimes exceeded) the growth rate of loans, thus exemplifying the expansion of crediting activities via draws upon savings.

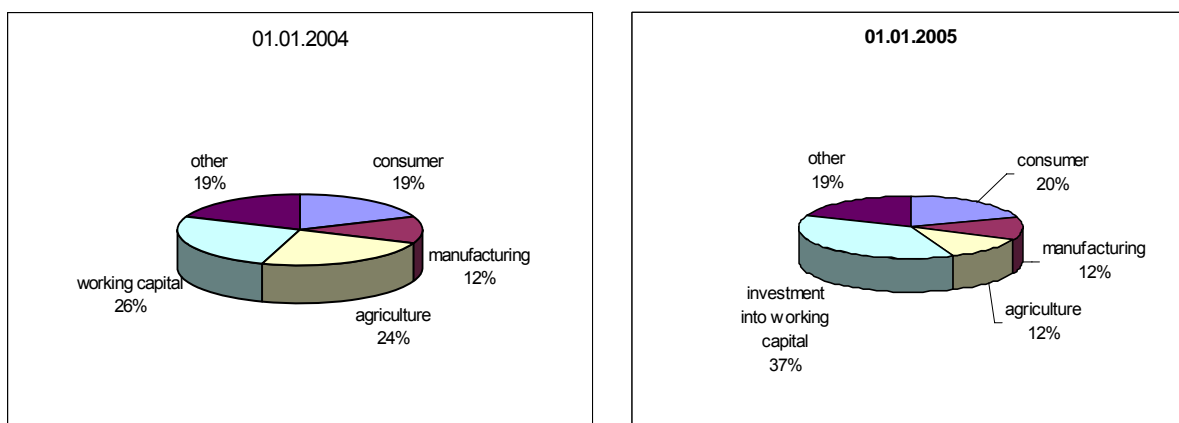
Tangible changes have taken place in the composition of deposits. The share of savings deposits increased from 7 percent to 17 percent in 2004. This growth is due to enhanced marketing activities by CUs which aim to describe savings products aimed at the individual needs of their members.

More active crediting was accompanied by an increase in average loan size. Earlier, loans in the amount of 200,000 to 500,000 soums were most common. Now loans in excess of 1 million soums are becoming most prevalent. It is notable yet, that CUs do not target any groups besides their own members, their loan products are not numerous, and they are differentiated only by interest rates. Although the amount and maturity period of loans are very flexible, they are limited by the size of each CU's loan portfolio. The primary criterion in issuing loans is the financial capacity of borrowers; hence, poor population groups are actually not represented here<sup>22</sup>.

<sup>21</sup> As of late May 2005.

<sup>22</sup> Full version of *TAHLIL*'s report. Figure 3. "Entrepreneurs' assessment of possibilities for well-off and poor individuals to get microcredit in various types of credit organizations".

**Figure 8. Composition of loan portfolio of credit unions.**



Source: WOCCU, Seminar's materials, May, 2005, Tashkent.

Demand for consumer loans remains most stable at a rate of 20 percent of CU loan portfolios. In 2004 the share of loans to replenish working capital has grown from 26% to 37% due to a significant reduction in agricultural loans. Given the fact that most borrowers are individuals, it can be said that most CU loans work for the development of entrepreneurial activities and consumer purposes.

Although the process of increasing CU capitalization is not yet comparable with the capitalization of the banking sector, their rates are impressive: as of early 2005 CU capital amounted to 950 million soums having grown 250% since 2003. Capital portfolios consist mainly of charter capital formed with contributions from CU members. A reduction in the average individual's share contribution from 5,000 soums to 2,000 soums allowed CUs to expand their clientele and increase their charter capital.

#### **Main problems of CU's development include:**

- **Barriers in asset growth.** There are several legislative barriers which are hindering asset growth. These include a ban on all types of activities except for accepting deposits and issuing loans. In addition there are caps on real estate investments which permit no more than 10% of assets. These limitations are burdensome due to small amounts of assets and CU capital.
- **Loan indebtedness.** This group of problems is divided into two parts. The first is related to ensuring loan repayment. Often ignoring CU requests for assistance, bailiffs usually focus on collecting unpaid bank loans where loan amounts are substantially higher.

The second group of problems is related to the methodology of overdue loan assessment. In commercial banks loans are regarded as overdue if the period for repaying of principal has begun. CUs on the other hand, consider the loan overdue after in interest payment is one day late. This approach requires the establishment of a reserve fund to be formed from CU assets, and thus a reduction in loan capacity and CU revenues.

#### **2.4 Credit lines of non-budgetary funds and international financial institutions.**

Preferential microcredit lines of the following non-budgetary funds and international financial organizations are offered in Uzbekistan:

**1. Fund for Support of Dekhkans and Farmers under the Association of Dekhkans and Farmers** provides:

- Preferential crediting of dekhkans and farmers if collateral, insurance or other guarantees of loan repayment are provided;
- Issuance of loans for up to 3 years to new dekhkans and farmers to form start-up capital;
- Working capital to new small enterprises, membership in ADF after repayment;
- Partial participation in forming charter funds for dekhkans and farmers given an insufficiency of their property as collateral for foreign loans received.

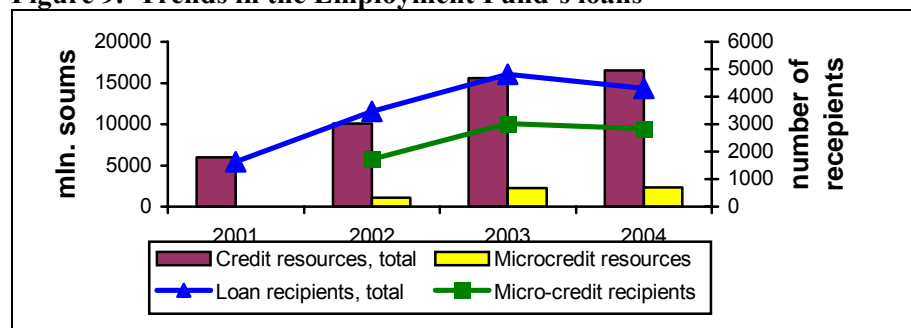
**2. State Fund for Employment support (SEF)** under the Ministry of Labor and Public Welfare issues loans to retain and create new jobs. SEF funds are formed by contributions from companies, institutions and organizations into to the Wage Fund (WF). Starting in 2002 the development of household-based businesses among poor families has been the priority for WF microfinancing.

For the period between 2001 and 2005 the total amount of WF's loan portfolio amounted to 50 billion soums, of which 12 percent (6.1 billion soums) went to microcredits. The number of clients who used WF's microcredits has substantially grown, reaching 8,000 persons. The average size of microcredits was to 0.9 million soums<sup>23</sup>.

A list of services by credit lines is given in Annex 1 (Table 19).

The Ministry of Labor and Public Welfare annually forms territorial programmes for public employment and identifies priority districts for microcrediting. It envisions earmarking 16.9 billion soums in loans for the period of 2005-2006, 6.2 billion of which will be distributed in 51 districts of the republic with high unemployment level.

**Figure 9. Trends in the Employment Fund's loans**



Source: Ministry of Labor and Public Welfare

Analysis has shown that microcredits are most attractive for agricultural practice (particularly for livestock farming) and forming start-up capital. The advantages of non-budgetary loans fund are obvious: low interest rates<sup>24</sup>, opportunities to obtain cash loans, longer loan maturity and an extensive grace period. All the same, problems of the use of non-budgetary fund credit lines include:

<sup>23</sup> As of May 2005.

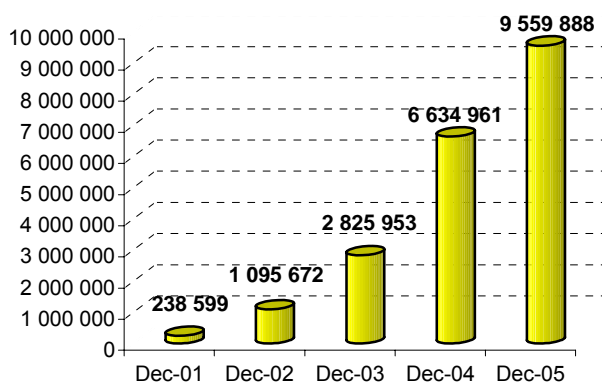
<sup>24</sup> To form start-up capital – 1/6 of the current refinancing rate of Central Bank; for the development of dekhkans and farmers, the purchase of agricultural equipment, the construction of farm buildings – 1/3 of the refinancing rate; for the production and extensive processing of raw materials, local industrial development – 40% of the refinancing rate; for other purposes – 45% of refinancing rate. The bank margin for microcredits from the Employment Fund and ADF is set at 50% of the preferential rate. The bank margin for other loans is set at 45% of the preferential rate.

- **Limitations.** Credit resources of all non-budgetary lines are limited and continue to decrease due to a reduction in the rates of the WF's deduction for Employment Fund from 1.5% in 2002 to 0.5% in 2005. Lower capacity requires the Fund to focus lending on the development of household-based businesses in areas where access to loans from other sources is limited.
- **Low level of efficiency.** The low amount of unpaid and overdue loans and interest is a testament to the efficiency of WF microcredits. Loans do not achieve targeted social objectives, such as increasing the income of poor families, due to the fact that the mechanism for issuing loans without collateral is virtually nonexistent, despite provisions for its implementation.
- **Remote location of banking institutions.** It is necessary to have a bank account to get a loan. This is a hindrance for rural entrepreneurs due to the distant location of banking institutions. Furthermore, it is essential to register with the local department of justice although the money required to do so may not be available.

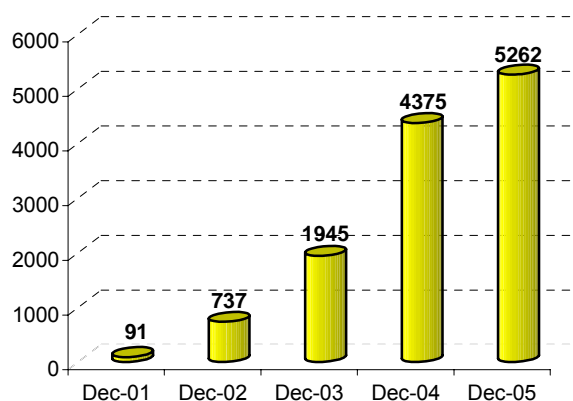
## EBRD credit line

The particular need for EBRD loans is due to the following factors. First, as opposed to other banks<sup>25</sup>, EBRD does provide funding for trade. Secondly, the salaries of loan officers depend directly upon the number of loans issued. Thirdly, clients may use the loan at their discretion, not necessarily in accordance with their business plan. Furthermore, there is another essential convenience – loan terms and procedures may be changed at the client's request. Interest payments are made both monthly and in full prior to loan maturity.

**Figure 10. EBRD credit line in Uzbekistan: Loan Portfolio (USD)**



**Figure 11. EBRD credit line in Uzbekistan: Number of loans issued**



Source: [www.j-usbp.com](http://www.j-usbp.com)

### 3. Analysis of the legal and regulatory framework for microfinancing

#### *Legal and regulatory framework for commercial banks' microfinance services.*

Analysis has shown that the legal framework which regulates the matters related to bank financing<sup>26</sup> of individuals and legal entities, and aimed at the encouragement of small

<sup>25</sup> The following international financial institutions opened credit lines in Uzbekistan: ADB, EBRD, OPEC, IFC, U.S. Eximbank, Islamic Development Bank, AKA Bank (Germany), Bankgesellschaft (Germany), Dresdner Bank (Germany), Khipo Vereyns (Germany, Italy), ABN-AMRO Bank, Bank Nationale de Lavore/Sache, Kommerzbank (Germany), Bank Gesellschaft Berlin (Germany), and Turkish Eximbank. These lines are provided by National Bank, Asaka Bank, and Promstroybank.

<sup>26</sup> (and consequently matters of microcredit and its related sub-categories)

businesses, has been fully created. Banks are entitled to engage in microcrediting without little hindrance but several general terms.

Bank microcredit is a loan amount equivalent to USD 5,000 for individual entrepreneurs and farmers who have not formed a legal entity and up to USD 10,000 for farms and small businesses operating which have not formed a legal entity.

**Panel 4. List of legislative and regulatory acts regulating crediting issues.**

**I. Laws of the Republic of Uzbekistan**

1. Law of the Republic of Uzbekistan «On dekhkans farmers» adopted April 30, 1998.
2. Law of the Republic of Uzbekistan «On farmers» adopted April 30, 1998.
3. Law of the Republic of Uzbekistan «On guarantees of the freedom of entrepreneurial activities» adopted May 25, 2000
4. Law of the Republic of Uzbekistan «On cooperatives» adopted 6 December 2001.
5. Law of the Republic of Uzbekistan «On limited and additional liability companies» adopted 6 December 2001.
6. Law of the Republic of Uzbekistan «On credit unions » adopted 4 April 2002.

**II. Decrees of the President of Uzbekistan**

1. Decree № VII-1987 of the President of Uzbekistan «On measures for further encouragement of development of private entrepreneurship and small businesses» adopted 9 April 1998.
2. Decree № VII-2554 of the President of Uzbekistan « On measures for further liberalization and reform of banking sector» adopted 21 March 2000.

**III. Resolutions of the Cabinet of Ministers of Uzbekistan**

1. Resolution №232 of the Cabinet of Ministers adopted 27 May 1998 «On improvement of the mechanism for encouraging development of small businesses ».
2. Resolution №75 of the Cabinet of Ministers adopted 4 March 2000 «On measures to support farmers, private entrepreneurs and other subjects of small businesses».
3. Resolution №104 of the Cabinet of Ministers adopted 24 March 2000 years «On additional measures for the reform of banking system».
4. Resolution №195 of the Cabinet of Ministers adopted 19 May 2000 «On additional measures to encourage the involvement of commercial banks in the development of private entrepreneurship ».
5. Resolution №366 of the Cabinet of Ministers adopted 10 September 2001 «On additional measures for provide financing , logistical support, customs privileges, banking and other services to small businesses and farmers».
6. Resolution №367 of the Cabinet of Ministers adopted 10 September 2001 «On measures to implement a microcrediting programme with EBRD».
7. Resolution №201 of the Cabinet of Ministers adopted 6 June 2002 «On measures to implement an EBRD microcrediting programme for full-fledged development of small businesses ».
8. Resolution №309 of the Cabinet of Ministers adopted 30 August 2002 «On measures to develop microfinancing in the Republic of Uzbekistan».

**IV. Regulatory acts of the Central Bank of Uzbekistan**

1. The procedure for insurance (including insurance of collateral, provided for loans to small businesses) of private entrepreneurs and small businesses approved by Resolution №292 of the Cabinet of Ministers adopted 26 July 1995 «On the issues of organization and activities of Madad agency ».
2. The statute for commercial bank microcrediting in soums and foreign currency of individual entrepreneurs and small farmers without legal entity status, is registered under № 902 by the Ministry of Justice on 29 February, 2000.



3. The statute for commercial bank microcrediting in soums and foreign currency of individual entrepreneurs and small farmers with legal entity status, is registered under № 903 by the Ministry of Justice on 29 February, 2000.
4. The statute for commercial bank credit policy is registered under № 905 by the Ministry of Justice on 2 March, 2000.
5. The statute for commercial bank credit records is registered under № 906 by the Ministry of Justice on 2 March, 2000.
6. The statute for commercial bank crediting of farmers and subjects of small businesses in soums is registered under № 907 by the Ministry of Justice on 7 March, 2000.
7. The statute for commercial bank crediting of individual entrepreneurs and small businesses through credit lines of non-budgetary funds (new edition) is registered under № 905 by the Ministry of Justice on 2 March, 2000.
8. The statute for commercial bank crediting of household based businesses from the credit line of the Employment Fund is registered under № 1146 by the Ministry of Justice on 3 June, 2002.
9. The statute for pawn shop operations is registered under № 905 by the Ministry of Justice on 2 March, 2000.

Basic statutory acts that regulate bank operations in microcrediting include:

- The statute for commercial bank microcrediting in soums and foreign currency of individual entrepreneurs and small farmers without legal entity status is registered under № 902 by the Ministry of Justice on 29 February, 2000.
- The statute for commercial bank microcrediting in soums and foreign currency of individual entrepreneurs and small farmers with legal entity status is registered under № 903 by the Ministry of Justice on 29 February, 2000.
- Resolution №104 of the Cabinet of Ministers «On additional measures for reform of banking system» adopted 24 March 2000.
- Resolution №195 of the Cabinet of Ministers «On additional measures to encourage the involvement of commercial banks in development of private entrepreneurship » adopted 19 May 2000.

The distinction between bank microcredit and traditional microcredit is in the various amounts of microcredit (USD 3,000 in NGO-MFOs); preferential interest rates (NGO-MFOs microcredit rates are not subsidized); the requirement of collateral and the procedures for preparing loan documentation (loan documentation of the banks is identical to other types of bank loans while in NGO-MFOs it is more simplified.)

**Panel 5. List of documents to be submitted by small businesses with legal entity status to apply for microcredits:**

- Loan application for microcredit;
- Business plan with mandatory indication of cash flows;
- Accounting statement for the last reporting period approved by the tax inspection committee.

Individual entrepreneurs and dekhkans farmers without legal entity status need to submit the following documents to the bank:

- Microcredit application with an indication of the loan applied for;
- Business plan with mandatory indication of the loan's purpose.

Furthermore, individual entrepreneurs or farmers shall personally submit his/her passport, a copy of which will be included in the credit file.

In order to prevent the risk of non-repayment, borrowers must submit a guarantee, with the essential stipulation of liquidity. Borrower may provide any of the following types of guarantees to the bank:

- Property or security collateral;
- Bank or insurance company guarantee;
- A third person guarantee;

- Insurance company's policy insuring the risk of non-payment of loan by the borrower;
- Guarantee of community council of mahalla (neighbourhood), village, or aul (hamlet).

Analysis of the current statutory acts in bank microcrediting invites the following conclusions:

- A definition of “bank microcrediting” emerged in 1999<sup>27</sup>. The main distinction between the definitions of “microcrediting” and “crediting” was in the maximum amount of microcredit and ability to get 50 percent of microcredit in cash, while repayment of the cash and its interest was to be paid only in cash.
- Statute # 903 is related to microcredit for legal entities, undertaking their operations as small entities or farms. As a rule, they have access to regular bank loan resources and are not the most in need of microcredits. The mechanism for issuing microcredit and protecting the banks from the risk of non-repayment is identical to that for issuing regular loans, regardless of loan amount.
- Commercial bank microcredit for individuals is offered to those already legally registered as individual entrepreneurs. State registration, *inter alia*, requires the payment of a registration fee, which complicates access to microcredits for those who want to start their entrepreneurial activities from the moment disbursement.

#### **Legal and regulatory framework of the microfinance service provided by NGO-MFOs.**

A definition of MFO appeared in the country after the adoption of basic Resolution #309 of the Cabinet of Ministers “About the actions for development of microfinance in Uzbekistan” on 30 September, 2002. Its objective was to create legal grounds for more active involvement of the population in entrepreneurial activities by introducing new microfinance instruments and grants by international financial institutions, foreign government organization, and non-government non-profit organizations<sup>28</sup>. It has created a favorable environment for the development of NGO-MFOs. The Ministry of Labor and Public Welfare of Uzbekistan was named as the coordinator of microfinance development programmes.

Microfinancing for legal entities and individuals – residents of the Republic of Uzbekistan – is offered in local currency in the amount of no more than equivalent of USD 3,000 per borrower in terms of urgency, charges, and repayment. Grant funds of donor organizations in foreign currency used as the source of microfinance are transferred to the corresponding account of an authorized bank and need to be sold at the interbank currency exchange rate.

Main problematic aspects are as follows:

- Resolution #309 stipulates a limited legal regime. Despite the inclusion of an annex which lists donors, it remains unclear whether this list is exclusive. (In other words, it is unclear whether MFOs using the funds of other donors, not listed in the annex, may also work in the format of microfinance.) In short, the resolution does not encompass all types of MFOs.

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<sup>27</sup> Statute # 755 for commercial bank crediting of individual entrepreneurs and small businesses from non-budgetary funds credit lines adopted 20 July, 1999.

<sup>28</sup> Starting with traditional donors and ending with development banks and international NGOs: ACDI/VOCA, FINCA through USAID, ADB, UNDP, Open Society Institute (Soros Foundation) – co-financing; Mercy Corps (with support of UK government); Netherlands Organization of International Development and Cooperation (NOVIB); U.S. NGO “Joint Development” (JDA), NGOs under JICA (Japan) – training programme; Northwest Medical Team and Global Lifeline NGOs – U.S. NGOs

- Registration procedures and the legal status of NGO-MFOs are unclear. JSC and LLC may be appropriate mechanisms for microfinance activities for MFOs striving to raise individual savings. Both legal forms combine limited liability of the participants with centralized management. Features of the other three legal forms (cooperative (full or special partnerships), manufacturing cooperatives and unitary companies) make them unsuitable for these purposes<sup>29</sup>.
- The disbursement of microcredit by NGO-MFOs is limited due to restrictions on the access and use of cash. Bank clients are entitled to withdraw funds from their deposits as they wish without any limitations. Banks must complete these transactions within one day of receiving a client's payment order or in accordance with the terms stipulated in the agreement. The bank is also responsible for delays in carrying out transfers or the requests of clients. One problem banks and NGO-MFOs deal with is that regulatory and legal acts related to cash handling contradict the provisions of the Civil Code. NGO-MFOs suffer most from these limitations as they are expected to disburse their loans in cash.

Problems regarding cash limitations for microfinance sector were addressed in Resolution #309 (for NGO-MFOs), in Resolution #348<sup>30</sup> (for CUs) and Resolutions #201<sup>31</sup> and 367<sup>32</sup> (for EBRD sub loan programmes through the banks). This approach should not be changed in future. Rather is preferable to preserve the consistency of regulations and reinforce the status of microfinance.

- An additional problem for MFOs centers on restrictions banning the storage of cash from loan repayments on their premises. Although it would be preferable for them to use these cash payments in order to issue new loans, MFOs must the cash in the bank. Subsequently, the deposit of these funds feeds the problems associated with cash withdrawals. However:

1. All legal entities regardless of ownership form must observe the Rules for cash transactions for legal entities, approved by the Central Bank and registered by the Ministry of Justice under Decree #565 on 17 December 1998. This means no one will make exceptions for MFOs.

2. In accordance with Article 4 of the Rules, caps for the amount of remaining cash will be set by the banks in agreement with the managers of the organizations. These caps can be reviewed as required. Hence, this matter could be addressed by expanding the authority of MFOs to increase the amount of cash kept at the cashier and by widening the norms for cash use.

### **Legal and regulatory framework of microfinance services provided by CUs**

CUs operate in compliance with the law "On credit unions". It provides a definition of CUs and describes their types of activities. The law also provides procedures for state

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<sup>29</sup> In case of cooperatives, liabilities of the members for liabilities of the cooperatives is not limited (except for some cases in special cooperatives), and a minimum amount of charter capital is not stipulated by law. Commercial activities of the cooperative may be undertaken with any of the full-fledged members on behalf of the cooperative in accordance with charter documents. In the absence of centralized administration, the management of cooperative's activities can be a complicated task. Manufacturing cooperatives are formed mainly for manufacturing purposes and should meet many requirements and terms unsuitable for the non-manufacturing sector, such as microfinance activities.

<sup>30</sup> Resolution of the Cabinet of Ministers "On activities for implementation of the project "Development of small businesses and microfinance" with participation of Asian Development Bank" issued 8 November 2003.

<sup>31</sup> Resolution of the Cabinet of Ministers "On activities for implementation of the Programme of European Bank for Reconstruction and Development for full scale development of small businesses".

<sup>32</sup> Resolution of the Cabinet of Ministers "On activities for implementation of the microcrediting programme by European Bank for Reconstruction and Development" adopted 10 September 2001.

registration of CUs and obtaining Central Bank licenses, and it better describes the authority of the Central Bank to regulate CU activities.

The law stipulates a minimum number (50) of credit union members. The rights and responsibilities of CU members as well as its foundation documents such as the charter are indicated separately. The law also determines the procedure for issuing of loans, paying dividends and reorganizing and closing the CU.

#### **Panel 6. Statutory acts regulating CU activities**

1. **Rules for financial transactions of credit unions**<sup>33</sup>, related to forming capital, crediting, raising funds in the form of credits and deposits as well as investing available funds in order to minimize the risks arising from credit union activities.

In accordance with the Rules to ensure sustainable functioning of CUs, the total amount of capital must be no less than 15 percent of a credit union's assets. A CU is entitled to provide loans only to its members. The amount of a loan provided to one borrower or group of mutually related borrowers may not exceed 25 percent of the credit union's capital. The total amount of a trust-based loan issued to one borrower may not exceed 10 percent of the CU's capital.

A CU may raise funds through savings or fixed-term deposits based on the deposit agreements between the CU and its members.

The rules envisage the observance of the coefficient of current liquidity estimated as the ratio of liquid assets and deposits with a repayment period of up to 30 days to the amount of liabilities without fixed term and period of execution up to 30 days. The figure for the coefficient of current liquidity should be no less than 20 percent.

2. **Rules for the approval of the minimum amount of Authorized capital, the amount of the registration fee, the qualification requirements for the chief executive officer, forms and procedures for registration, the issuance of a license for credit union activities, and the certificate form for payment for share contributions by members of credit unions**<sup>34</sup>.

The minimum amount of CU authorized capital is set at:

- Equivalent to USD 20,000 for credit unions created in the city of Tashkent;
- Equivalent to USD 10, 000 for credit unions created in other residence areas.

The CU is charged a fee for state registration in the amount of 0.1% of the minimum amount of the authorized capital of CU. Qualification requirements for the head of the CU's executive body include higher education, no less than 3 years work experience in the financial sector, and a flawless business reputation.

3. **Guidelines for the accounting practices of credit unions**<sup>35</sup> determine the rules for accounting practices and reporting: recordkeeping and control over financial transactions; the structure of the accounting office; modes of servicing CU members; methods of document turnover; and volumes and procedures for accounting statements based on international standards.

Given all of the existing limitations to CU's, their rapid development in 2004 demonstrates that the legislative and regulatory framework for CUs was progressively encouraging.

The further development of legislative and regulatory framework for microfinance is expected to proceed in two stages:

1. The adoption of the Resolution of the Cabinet of Ministers with the objectives to regulate the most pressing current issues faced by MFOs: clear registration procedure of various types of MFOs, provision of MFO access to alternative financial sources and a regime for further taxation.
2. Development of the Law "On microfinance in the Republic of Uzbekistan" with an objective to regulate the entire spectrum of issues related to the MFO activities in

<sup>33</sup> Approved by the Resolution # 21 A/2 of the Board of the Central Bank on September 14, 2002 and registered at the Ministry of Justice under # 1179 on 14 September, 2002.

<sup>34</sup> Registered by the Ministry of Justice under # 1151 on 21 June, 2002.

<sup>35</sup> Registered by the Ministry of Justice under # 1228 on 27 March, 2003.

Uzbekistan. Adoption of this law will have a positive effect upon the microfinance sector in that it will form an optimal legal framework.

#### **4. Problems of microfinancing that require a legislative solution**

##### **The regulation of MFOs**

Questions regarding the drafting of legislative regulations for MFO activities can be classified into three groups:

1. Shall the norms of prudential<sup>36</sup> regulation provisions be applied?
2. When and what norms of prudential regulation provisions shall be applied?
3. What shall be regulated: organizations carrying out which types of activity?

##### ***Shall the norms of prudential regulation provisions be applied or not applied?***

Experts note that even having hundreds of thousands of clients, microfinance rarely occupies a large enough portion of the country's assets to pose a serious risk for the banking and payments systems as a whole. For this reason the only sound reason for the availability of the prudential regulation provisions for MFOs accepting deposits is the protection of the MFO<sup>37</sup> depositors' interests. Sound reasoning is strengthened under the conditions of Uzbekistan's market economy when financial instability may be provoked by additional non-economic factors.

The majority of specialists express the same opinion that it is necessary to apply prudential provisions to those MFOs which accept deposits. This requires obtaining a license from a regulatory body. Under the present conditions in Uzbekistan only one regulatory body possesses the resources, experience and independence for necessary to carry out this task. That regulatory body is the Central Bank of the Republic of Uzbekistan<sup>38</sup>.

The norms of prudential provisions should not be used for solution of those issues which do not require organizations' financial viability. Minimal non-prudential requirements including provisions of the Civil and Criminal Codes<sup>39</sup> would suffice for those MFOs which do not accept individual deposits and the regulation can be limited to monitoring with an insignificant degree of administrative authority.

##### ***When and what norms of prudential regulation provisions shall be applied.***

The majority of local MFOs defy commercial definition of microfinance services. Secondly, NGO-MFOs want to keep their NGO status and under these terms they get permission to draw upon loans and individual deposits as resources of finance although doing so is contradictory from a legal point of view. Third, according to survey results MFOs do

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<sup>36</sup> Regulatory provisions or supervision are prudential when they are directed to the protection of financial reliability of licensed mediators to avoid instability of the financial system and losses for small depositors who lack special knowledge.

<sup>37</sup> Development of microfinancing does not stay idle. Thus, as soon as the developments of MFOs, which accept deposits, reach to a certain level, in addition to interest protection, issues of systemic risks will arise. Failure of licensed MFO with relatively small assets but with a significant number of clients may discredit the whole concept of microfinancing.

<sup>38</sup> There are significant differences in opinions: from supervision by association of microfinance institutions (self-supervision) up to transfer to the responsibilities of the body exercising general supervision over financial institutions. The experience of other countries in use of the mechanism of self-regulation illustrates the failure of this approach.

<sup>39</sup> They are simpler for execution and are not as expensive as the prudential provisions.

not yet provide loans with profit margins high enough to cover interest payments and the protection of deposits upon which they are willing to draw.

Analysis has also shown that profit margins of existing MFOs are yet not high enough to cover the financial and administrative expenses that come with accepting deposits and without depleting their own capital. The “Barokot” MFO, however, may be an exception as they have accomplished a high level of operational cost-recovery.

Under such circumstances, and considering the popular distrust of financial systems in CIS countries, which is difficult to overcome, it is inexpedient to permit the existing MFO to accept individual deposits without clear requirements such as a license from a regulator.

*Deposits of enterprises and deposit-substitutes.* In a number of countries MFOs can carry out self financing by issuing commercial securities, bonds, or analogous instruments in the domestic funds market as well as directly releasing large deposit certificates. Unlike individual deposits, these instruments are purchased by big investors. Although MFOs in Uzbekistan are still relatively young, it is necessary to consider the regulatory methods of this process in the development of a law on microfinancing. The complication is in the lack of a unanimous opinion as to how to regulate the work with such instruments<sup>40</sup>.

*Member's savings.* Disputes about the selection of regulatory provisions center mainly upon NGO-MFOs created by donor resources. Because of tendencies such as donor fatigue observed in the world, MFOs which began their activity by granting loans are now thinking of accepting deposits from their own members.

Although it is often said that since such organizations accept deposits only from their members and not from the general public, they should not be subject to the prudential supervision. However, such an argument seems unconvincing because of two circumstances: First, when such MFOs develop the opportunity for its members to control management occurs not higher than those of the depositors of a commercial bank. Second, the notion of membership may become faded. For example, an MFO which functions on a larger geographic scale can draw deposits from a broad territory. In this case it is logical for those MFOs to simply offer membership to anyone willing to make a deposit.

*Rate setting of prudential provisions: minimum capital amount.* There is a direct link between the number of licensed new enterprises and the effectiveness of supervision over them. As the resources of a supervisory body are limited, requirements regarding minimum capital are used as a criterion for selection.

Taking into account the lack of significant domestic experience in licensing and running the practical aspects of supervisory practice in microfinance, it is necessary to take a conservative approach from the very beginning. In time, the requirements can be adjusted in favor of by-laws mitigation.

As the microfinance market develops MFOs which accept deposits will undoubtedly emerge. That is why the question of minimum capital requirements<sup>41</sup> for such MFOs

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<sup>40</sup> A group of analysts believe that buyers of these securities should independently oversee the financial reliability of MFO-issuer. In this case regular provisions regulating the securities exchange should be applied. Another group (they do not distinguish between corporate deposits and individual deposits, and are skeptical towards local legislation on securities and their practical application) insists on the application of prudential provisions to MFOs – the issuer of these securities.

<sup>41</sup> In accordance with the law “On joint stock companies” the minimal charter capital of an open JSC must equal 500 minimum monthly wages at the moment of registration. But resolution # 189 of the Cabinet of Ministers adopted April 19, 2003 has set new minimum requirements to the charter capital of an open JSC equivalent to USD 50,000. The minimum amount for a closed JSC (no fewer than 3 but no more than 50 shareholders; if more, it should transform into an open JSC within 6 months) must equal 200 minimal monthly wages.

necessitates legislative confirmation. In this context it will become increasingly important to adopt a law which describes mechanisms for the transfer of noncommercial MFOs into commercial MFOs and also into MFOs with the right to accept individual deposits.

*Liquidity Requirements.* As a whole, there is no need to raise the liquidity requirements of MFOs in comparison with the available analogous requirements for commercial banks.<sup>42</sup> There are two strong arguments in favor of this statement.

First, the liquidity indicator established for domestic commercial banks has already surpassed the prudential norms of the Basel Committee.<sup>43</sup> It means that this norm in Uzbekistan is reinforced at 2 %. Second, analysis of the activities of existing MFOs shows a high (95-98%) loan repayment rate. The level of overdue and bad loans is much lower than in banks.

At the same time, opinions regarding the lack of liquidity requirements are not accurate. The high rate of return on MFO loan portfolios is less stable in comparison with bank portfolios and most importantly, it can worsen quickly since the microfinance portfolio lacks insurance. In addition, MFOs have high transaction costs and they have to charge high interest rates. Given the higher transaction costs and the same level of unpaid loans, MFOs will lose their capital much faster than the commercial banks.

Another argument for available liquidity requirements is the fact that microfinancing in Uzbekistan is a type of activity and MFOs as organizations have only recently emerged. MFO management and staff are relatively inexperienced, and the Central Bank as a supervisory body also does not have experience in analyzing and managing the risks in this sphere. Moreover, existing MFOs are growing rapidly, thus increasing the burden for management and regulation systems.

For the abovementioned reasons, liquidity requirements for MFOs authorized to accept individual deposits should be identical to requirements for commercial banks. These requirements must be upheld for a certain period until MFOs demonstrate their capacity to manage risks successfully and the Central Bank shows that it can promptly respond to emerging problems.

Domestic MFOs can object that liquidity requirements cause lower rates of return of capital or higher interest rates. However, analysis shows that the demand for microloans is not susceptible to interest rates: even under the current almost loan shark interest rates the demand for microloans has been consistently high. As the state has not introduced an interest rate ceiling, our domestic MFOs enjoy broad opportunities in the interest rate game.

*The development of reserve funds in case of non-repayment of loans.* National MFOs use group solidarity guarantees as collateral for their microloans. In principle, it enables the use of such a scheme as a requirement in microfinance. But it may become a convenient option only if all MFO use such guarantees.

Most loans were provided based on the principle of solidarity in the initial period of MFO operations. Analysis now shows that MFOs more frequently use individual loans with collateral. Furthermore, there is no evidence supporting higher rates of repayment of group solidarity guarantees than individually guaranteed loans.

Taking into account these circumstances the need to development appropriate regulatory framework<sup>44</sup> seems justified. It is particularly true for local MFOs which provide microloans

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The minimum charter capital of JSC (number of participants no more than 50) must be the equivalent of 50 monthly minimum wages at any given moment.

<sup>42</sup> Current requirements for capital of commercial banks is set at 10 percent.

<sup>43</sup> According to the norms of the Basel Committee, the coefficient of capital sufficiency is set at 8 percent.

<sup>44</sup> Regulatory framework should address a number of issues: division/indivisibility of reserve fund, cases for its use, its sources, indexation, limitations, and force majeure circumstances, etc.

mostly for a short term (in average up to 6 months). It is believed that the delay in repaying short-term loans is more than 60 days. The probability of non-repayment of microloans without collateral issued for three months with weekly schedule of payments is higher than loans ensured by collateral issued for two years with a monthly repayment schedule.

Requirements for the security and operational procedures of MFOs. Requirements for security and the operational procedures of MFOs with financial resources are stipulated in Statute #565 for cash transactions of legal entities. From an executive point of view, the requirement on the use of police security services is particularly complicated because of the pricing monopoly.

Indeed the observance of the Statute entails additional costs for MFOs and it should be reviewed but not terminated. The issue is that the Rules are mandatory for all domestic legal entities regardless of ownership form. It means that their review must be enshrined in the legislative act which directly concerns microfinancing.

Mechanisms for legal transformation. There is a whole range of issues related to the transformation from one type of organization into another. This issue is of secondary importance for national MFOs since there are no potential nominees for transformation yet. However, with the expansion of microfinance, the solution for these issues may encounter serious regulatory barriers. These may include for example, limitations on foreign participation, inequality in taxation for the transfer of loan portfolios, labor legislation issues with regard to staff transfers, etc.

Since all of these issues are features of microfinance, the usual development of separate regulatory instructions and their incorporation into the available legislative framework is inexpedient. All of these issues must be reflected in a separate law.

#### ***What must be regulated: organizations or types of activities?***

In response to this question the opinions of specialists tend towards supporting prevailing microfinance regulations which encompass whole sets of activities regardless of the type of organizations implementing them. Solid arguments may be brought in favor of both approaches yet in the case of Uzbekistan it seems expedient to develop a Law “On Microfinance” or “On Microfinancing Organizations” where both approaches would be considered.

This is necessary due to the lack of legal framework for MFO operations (regulation by the type of organization) and uneven regulatory framework of the types of microfinance services offered by various financial institutions.

The planned development of the Law “On Microcrediting” with the direct involvement of the Central Bank meets with some complications as this very sphere has already been nearly completely. The development of regulations for the remaining types of the microfinance activities requires an expert’s team outside the Central Bank.

#### **4.2. Taxation of MFOs**

Issues related to the taxation of MFO transactions are not uniform in different countries. The basic approach to the solution of these issues is based on the differentiation of taxes by financial transactions. These include for example, value added taxes for providing loans, taxes on interest income, and taxes on net profit. Also an approach is suggested when same conditions are created for organizations of different types. For example, in conducting the same financial transactions, the tax rate should be the same regardless of the parties involved.



The pressing nature of the matter is clearly felt in Uzbekistan. Tax breaks provided within the framework of the Resolution #309 expire at the end of 2005 and both practicing MFOs and as new potential institutions will naturally ask the question - what will be next?

Acknowledging the start-up period for the development of local MFOs and given the particular social significance of their activities, it seems expedient to prolong the income tax exclusion for the next three years (from January 1, 2006 till December 31, 2008). This practicality is determined by the following factors:

- *Necessity to encourage microfinancing as a type of activity* regardless of the type of MFO. It allows avoiding ungrounded privileges for one type of MFO above others.
- *Encourage establishment of financially sustainable MFOs.* As it is known, existing MFOs in Uzbekistan are not financially sustainable today. The current state of taxable revenues of MFOs is such that levying taxes on their activity does not significantly impact state budget revenues yet it will definitely slowdown and terminate MFO operations.
- *Accumulation of loan resources.* Currently the loan resources of the current MFO are too limited. If the tax privileges are abolished (or not re-adopted) these resources will be further reduced, thereby discrediting the whole concept of microfinance.
- *Focusing on the social mission of MFOs.* MFOs provide a public good and their profits are reinvested to reduce poverty. Along with this, a particular social role of MFOs in Uzbekistan is strengthened in the light of problems such as unemployment and the current demographic situation.

Conditions for tax benefits may include the targeted use of deductible funds for further provision of microfinance services, covering of the operational costs of an MFI, and the development of their infrastructure and logistics.

It is noteworthy that previously income taxation privileges were also provided to banks, and this tax break played an important role in the development of banking sector.

Although in accordance with the abovementioned it is necessary to exempt for the services on granting of microloans and microleasing from a value added tax.

#### **4.3. Access to external sources of borrowing**

In the microfinancing sector of Uzbekistan two segments clearly stand out as having the financial resources necessary for their activity: microcrediting of commercial banks and CUs. Although financial sources of the activity of the said segments also have problematic issues, they are in a better position in comparison with NGO-MFOs which are dependant exclusively on donor financing.

The increased trend of donor fatigue raises the issue of finding other sources of loan capital for both NGO-MFOs and all types of MFO as a whole.

**At present such sources may include the following:**

##### ***1. Establishment of relations with commercial banks thereby expanding access to commercial sources of funding.***

a) According to the draft of a new Resolution and its annexes (Annex 2) MFOs can receive commercial loans from domestic banks. In this case there is no need to use prudential regulation provisions regarding MFO-debtors, since the appropriate prudential norms are enshrined in bank licenses. Therefore, the receipt of bank loan capital cannot serve as an argument in favor of applying prudential provisions to a greater extent than to any other

debtor. This issue must be reviewed in the framework of the Law “On Microfinance” as it is related to a number of previously adopted legislative acts.

b) A particular issue in the MFOs’ relations with banks is the form of crediting. MFOs provide loans to its clients in cash, while commercial banks can not issue a cash loan to an MFO.<sup>45</sup> In this regard, the Resolution draft provides for the right of MFOs to receive cash money in the established procedure and on the first demand in the amount necessary for carrying out microfinancing, within the limits of resources available in their bank account.

c) By raising remaining cash limits, it is possible to ease the burden of MFOs dealing with cash transaction issues. Therefore, it is necessary to recommend in the draft Resolution that banks, together with MFOs, consider and define how to use cash received as microdeposits, taking into consideration projections for cash microloans. The recommendations passed by the Resolution of the Cabinet of Ministers automatically obligate the banks to settle this issue in favor of raising the cash limits.

d) For stimulation of bank loans to MFOs it is necessary to set lower classification of risks for these loans according to the bank’s liquidity coefficient. It allows banks to increase loans to MFOs, and to reduce the service cost to a certain degree.

In the future commercial banks with a developed affiliate network and broad clientele among small businesses and individuals will have to examine the conditions necessary to establish and develop separate divisions to provide microfinancing services. It enables the expansion of the microfinancing market and the diversification of bank operations.

d) It is absolutely essential to enable MFOs to interact with credit history bureaus. This supports MFOs’ efforts to reduce risks, and it provides debtors with the good credit history necessary to get new loans.

A credit history system was created in Uzbekistan in accordance with Resolution #197 of the Cabinet of Ministers “On action to form account information system” dated April 23, 2004. The National Credit History Institute (NCHI) was established within the Central Bank and the Inter Bank Loan Bureau (IBLB) was founded under the Banking Association of Uzbekistan. The task of these organizations is to collect and analyze information on loan transactions and their debtors as well as to provide information to commercial banks.

MFOs can provide information and use the services of IBLB by making contracts. The problem here may be technical support for the transfer and exchange of data, which requires significant funding, and may turn out to be too expensive for some MFOs. This is where donor support is needed.

## ***2. Increasing the population’s deposits (individual deposits)***

MFOs' operations structure implies that in the case of borrowing, small individual deposits will make up a significant part of the related liabilities. Banking institutions’ records show that this very category of clients is usually not able to assess the financial status of credit organization independently and in the case of MFOs making deposits is fraught with risk of losing the money of socially vulnerable groups.

If deposits in commercial banks are insured then common sense must stipulate that deposits in other organizations licensed by a supervising body must be insured as well.

For the protection of minor depositors’ interests, MFO membership in an individual deposits insurance system may be provided. In accordance with the Law “On Guarantees for Individual Bank Deposits”, a special fund was established in Uzbekistan to ensure compensation for citizens’ deposits in the case that the Central Bank withdraws a bank’s license. The compensation shall be paid in the full amount of the deposit up to the amount of

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<sup>45</sup> Banks are imposed a function to regulate cash circulation in the Republic of Uzbekistan.

one hundred times the minimum wage, and 90% of the deposit amount provided the deposit does not exceed 250 times the minimum wage.

MFOs with a Central Bank license to raise individual deposits can participate in the deposit guarantee system by making compulsory contributions to the aforementioned fund. The amount of quarterly calendar contributions is 0.5% of total deposits but payments stop when total contributions reach 5% of total deposits. Thus, the amount of contributions will not be so large as to impact the financial status and liquidity of MFOs.

The participation of Uzbek MFOs in the insurance system of individual deposits will enhance depositors' trust and raise the resource base for activities. The compensation amount set by the law as 250 minimum monthly wages will secure the depth necessary to cover MFOs' clients given the small amount of deposits. To achieve the indicated objectives it is necessary to amend the Law "On Guarantees of Individual Bank Deposits" or include a separate article (section) on microfinancing in the law.

#### **4.4. Maximum loan amount and interest policy**

*Maximum loan amount.* There is a significant difference of opinions on maximum loan amounts ranging from \$1,000 to \$5,000 and more. To set the maximum loan amount equal to \$3,000 is expedient due to a number of reasons:

- Ensure the continuity and sustainability of laws.<sup>46</sup>
- According to the definition of microcredit given in "Microfinancing Banks and their Activities" Bulletin, the loan amount must not exceed 250% of per capita GNP in the country.<sup>47</sup>
- The average microloan amount is circa \$140-150 at present. At the same time polls indicate that half of MFO clients would like to borrow in the amount \$500 and more, and one fifth of entrepreneurs need \$1,200-3,000 loans. (Table 13, Annex 1 to the report).
- This size loan allows the borrower to earn profits sufficient to satisfy needs and to reinvest even if the currently high interest rates (4-7% monthly) are maintained.
- This price segment is not covered by any financial establishment of the country.
- Consider of best innovative microfinancing practices. For instance, the maximum microcredit amount of Grameen Bank in Bangladesh is \$100-300, in Ethiopia it is up to \$673, in Morocco - \$5,300, in Nepal – up to \$1,000, in Pakistan - \$150, in Poland and Hungary - \$3,500, in Kazakhstan - \$3,000. In a number of West African counties (Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal, Togo, Guinea-Bissau) the maximum microloan amount is \$17. The average loan amount throughout Eastern Europe, Central Asia, and Caucasus is \$1,209.

Setting a maximum amount for microleasing at the level of \$10,000 is reasonable due to an array of arguments:

- Existing, although not extensive, experience supports this. Although the average amount of leasing transactions does not exceed \$2000, there are instances when the maximum value of property leased was up to \$10,000 (Panel 3).
- This level corresponds to the average value of domestically produced equipment although it is much lower than that of imported equipment.

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<sup>46</sup> This amount is specified in the basic resolution № 309.

<sup>47</sup> According to the World Bank data in 2000-2003 this indicator decreased from \$630 to \$420. The same indicator calculated with consideration of purchasing power parity (PPP) changed from \$1,490 to \$1,740.

**Interest policy.** Analysis has shown that microloans up to the amount of \$1,000 at a high interest rate produce good effect if the business costs of entrepreneurs range from \$600 to \$1,400 per month and the profit margin are about 30%. They are efficient for entrepreneurs whose business costs range \$1,500-3,400 per month at a profit margin of about 15-20%. When business costs exceed \$3,500 for an entrepreneur it pays to take loans on bank conditions because the profit margin is not sufficient to pay the high interest rates of MFOs and CUs in short term. Thus entrepreneurs in different financial positions face genuine market choice.

Despite the high interest rates of acting MFOs, it appears currently that there is no need for legislative regulation for the following reasons:

- First, demand for microcredits is significant even at existing rates and no downward trend is observed;
- High interest rates indicate the costs of the initial development period of domestic microfinance and the associated trial and error;
- Quantitative growth, economies of scale<sup>48</sup>, and the streamlining of MFOs operations will lead to reduction in rates to the most preferable level<sup>49</sup> from the entrepreneurs' point of view (3-4% per month);
- Transition to uniform standards of financial reporting as well as the gradual streamlining of procedures will imminently lead to higher MFO efficiency, which in turn leads to lower interest rates;
- Catering to entrepreneurs' demands, MFOs will increase loan terms up to 1-1.5 years<sup>50</sup> which will inevitably result in reduction of interest rates.
- Current policies geared towards creating various domestic microfinance institutions will steadily enhance the competitive environment in this segment, which will lead to falling interest rates.

## **5. Assessment of demand for microfinance services in Uzbekistan**

Demand trends for microfinance services will be defined by the following nationwide tendencies:

- Macroeconomic stabilization and currency liberalization;
- Institutional reforms in agriculture;
- Decentralization;
- Further liberalization of the finance sector;
- Re-orientation of businesses towards production.

Three broad client groups may be underlined<sup>51</sup> among MFO clientele:

1. Entrepreneurs owning small businesses and registered as microfirms as well as entrepreneurs without the status of legal entity.

2. Dekhkans (peasant) and private farms.

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<sup>48</sup> Larger is MFO portfolio, more it can reduce interest rates.

<sup>49</sup> See Table 15, Annex 1 to the report.

<sup>50</sup> See Table 14, Annex 1 to the report.

<sup>51</sup> Materials from "Analysis of microfinancing development in Russia, 2003" study results were used in this estimate. The study was implemented within the framework of the USAID Project "Inter-Parliamentary Working Group on Small Business "RF Duma – the US Congress".

3. Socially unprotected population groups, including the unemployed, people with low income and migrants.

### **Entrepreneurs owning small businesses and registered as microfirms as well as entrepreneurs without the status of legal entity**

***MFO clientele scale assessment among microfirms.*** From the point of view of size, legislation<sup>52</sup> and government statistics single out the following basic categories of small businesses:

- individual entrepreneurs;

- microfirms with the average number of employees in the manufacturing sector not more than 20 people annually, in services and other non-production branches – not more than 10 people annually, in wholesale, retail sale, and catering – not more than 5 people annually;

Small enterprises with mean annual number of employees employed in the following industries:

- textiles and food processing, metal processing and instrument making, wood processing, furniture and construction materials industries – not more than 100 people;

- machinery manufacturing, metallurgy, fuel, energy, and chemicals, agriculture and processing of agricultural products, and other industrial and manufacturing sectors – not more than 50 people;

- research, science services, transportation, telecommunication, services (except insurance companies), commerce and public catering, and other non-manufacturing sectors – not more than 25 persons.

As a rule, legal entities with up to 10 employees are counted as microenterprises for the assessment of potential clientele of the most typical MFOs.<sup>53</sup> The same methodological approach has been applied in this calculation. Polling results show that the number of personnel in microenterprises regardless of the industry ranges from 2.7 to 9.7 people, i.e. less than 10 employees (Table 3 Appendix 1 to the report). Thus, all microfirms are included into the clientele base. According to survey results from 2004, the number of microfirms in Uzbekistan was 259,300.

Small enterprises do not usually make up part of the MFO clientele base. Generally speaking, they are bank clients as they need larger loans.

For a more accurate assessment of the scale of microfirms as a component of MFOs' programmes it is necessary to adjust the figure for those microfirms that do not have needs for external financing: about 20%, according to poll results. Taking into consideration this adjustment, the most realistic size of clientele base of MFOs among microfirms may be estimated around 207,400.

It should also be taken into consideration that microfirms may apply to banks for loans. The share of such microfirms also makes up about 20%. Taking into account this last adjustment, the number of potential microenterprise MFO clients comes to 155,600.

When speaking about securing access to financing for these enterprises it is important to mention that in fact *indirect support is provided to 989,900 persons employed in microfirms with up to 10 employees.*

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<sup>52</sup> Decree # UP-3305 of the President of the Republic of Uzbekistan "On making changes and amendments to the Decree of the President of Uzbekistan" issued April 9, 1998 "On measures for further encouragement for development of private entrepreneurship, small and medium businesses".

<sup>53</sup> These criteria are active in Europe. This limit was determined by FINCA International LLC in the project "Analysis of the state of supply and demand in the market of microfinance services".

***Assessment of MFO clientele base among entrepreneurs without the status of legal entity.*** Individual entrepreneurs correspond more to the classical MFO target group. Moreover, these types of entrepreneurs are more socially oriented and they adapt more easily to the challenges of the current economic situation. The individual enterprise sector provides employment to the most socially vulnerable groups of society.

Nationwide growth in the number of small businesses is supported by *buoyant growth of the number of entrepreneurs without the status of legal entity who represent the most dynamic type of entrepreneurs.*

According to 2004 results, 4,689,300 individual entrepreneurs were active in Uzbekistan. According to polls, individual entrepreneurs are concentrated mainly in commerce and the production of non-foodstuff goods. After adjusting for those who do not need external financing (38.3% in this group, according to polls), the clientele size of MFOs in the individual entrepreneurship sector amounts to 2,893,400.

Only 62.5% of this number (according to polls) can constitute MFO clientele. In other terms, the real size of MFOs' clientele base in terms of entrepreneurs without the status of legal entity is 1,808,400.

### **Dekhkans and private farms**

***Private farms.*** Analysis of demand for financial services by private farms shows that they opt for preferential bank loans, and thus they should not be included into the potential clientele base of MFOs. Thus, the average amount of loans issued by *Pakhtabank* to cotton growing private farms makes up about 4.8 million soums - much higher than maximum threshold for microfinancing provided by microfinancing organizations, which is equivalent to USD 3,000.

The average amount of microloans issued by commercial banks as a whole (including private farms) in favorable conditions is about 2.6 million soums. This figure significantly exceeds the average amount of microloans provided by MFOs which is 146 US Dollars.

Thus, demand for microfinancing services by private farms will not constitute a significant portion of demand on MFOs as the demand will be directed towards preferential loans provided by commercial banks.

***Dekhkan farms.*** Dekhkan and family-run farms are a clientele base for MFOs. According to legislation, they are may work with and without the establishment of a legal entity. Hiring permanent staff however is not permitted for dekhkan farmers without status of legal entity. Currently there are 4,500 thousand farmers registered in both categories in Uzbekistan.

But not all the dekhkan farms will become MFOs clients. First, according to polls, 18.3% do not need external financing at all, and only 26.7% of the rest became MFO clients. Taking into account these adjustments, the real size of the clientele base of MFOs with respect to dekhkan farms will constitute 981,600.

### **Assessment of MFOs clientele base among the least protected population groups**

***Unemployed.*** Uzbekistan population is approximately 26.1 million. Its labor force consists of 9,945,600 persons, of which 6 percent are unemployed according to the World Bank estimates. Thus, the total number of unemployed is estimated at circa 597,000.

But not all the unemployed have entrepreneurial qualities and accordingly, not all of them are potential MFOs clients. The key features defining and shaping entrepreneurial potential include: sex, age, educational level, and position and status at the last place of employment.

According to a number of studies the general social portrait of a manager/entrepreneur is as follows: age 30 to 49; more than 50% have a higher educational background. A breakdown of the unemployed in Uzbekistan by age groups illustrates that 43.3% of them are in the age favorable for entrepreneurial activities.

Young people from the ages of 16 to 30 constitute 55.3% of the total number of unemployed. It is the age when a person undergoes professional development and their profession is chosen. There is no data available about how many people in this category are capable of managing small enterprises but some studies in Russia for instance showed that perhaps 3-5% of this age group is capable. It is appropriate to mention that at this age lack of financial resources is one of the main obstacles in establishing a business (about 60% of the respondents of a sociological poll pointed to this factor, Table 7, Appendix 1). In this respect, the development of microfinance will not only rejuvenate domestic small businesses but realize the young generation's ambitions as well. The latter is especially important in the context of the demographic situation in Uzbekistan where unemployment among the young is more than 13%.

Thus, about 48% or 287,000 of Uzbekistan's unemployed could set up their own business in favorable conditions and produce demand for microfinance services.

**Low income population groups.** Demand for microfinancing services may also come from persons with such a low income that it is inadequate for a decent lifestyle. According to Ministry of Labor and Social Welfare data, in early 2005 there were 1,661,000 households receiving benefits as poor families in Uzbekistan. Furthermore, 254,000 households are receiving financial aid. Thus, the number of households living below poverty line in Uzbekistan is estimated at 1,915,000.

**Labor migration.** From a methodological point of view, this category must also be included into any calculation of MFOs' client base because a portion of labor migrants would stay in the country and attempt to launch their own small business if they had better access to financial resources.

According to *Tong* NGO data, average annual labor migration in Uzbekistan in 2002-2004 reached about 1 million people. The mean migrant age was 35. Unlike migration processes in more developed countries where migrants have higher education and significant work experience, the migration contingency in Uzbekistan is represented by poor groups.

The gap between average per capita income in Uzbekistan and the neighboring states of Kazakhstan and Russia constantly feeds labor migration flows from Uzbekistan. One particularly important aspect here is the fact that the aforementioned gap in average per capita income is increasing. While 3-4 years ago it was 30-40%, it is now several fold. This very gap along with a group of factors hindering the development of small businesses supports a persistent outflow of labor migrants from Uzbekistan to neighboring countries and Russia.

But not all migrants possess the aptitude to become entrepreneurs. In this respect, not all of them are potential clients for MFOs. Applying the same methodological approach used to calculate the potential scale of clients among the unemployed, 48% or 480,000 migrants might launch their own business in favorable circumstances and produce demand for microfinancing services.

**Table 2. Consolidated table of MFO clientele structure**

	<b>Total</b>	<b>as MFO clients</b>
Microfirms	259,300	155,600

Entrepreneurs without the status of legal entity	4,689,300	1,808,400
Dekhkan farms	4,500,000	981,600
Unemployed	597,000	287,000
Poor population groups	1,915,000	1,915,000
Labor migrants	1,000,000	480,000
<b>TOTAL</b>	<b>12,960,600</b>	<b>5,627,600</b>

Source: Author's calculations

Thus, the number of potential MFO clients among businesses is estimated to be 1,964,000. These are operating subjects that can produce demand for microfinancing services. The clientele base from the least protected groups of the population is 2,682,000. The size of clientele base of the most social sector in Uzbekistan, agriculture, is 981,600.

In general, 2.7 million people from the least protected sections of the population are ready potentially to launch their own business, which amounts to approximately 27% of domestic labor force.

### **Total estimated demand for microfinance resources**

For this calculation, two cost estimates of demand for microfinancing services were calculated<sup>54</sup>:

1. Cost estimate of the demand based on current amount of loan equivalent of \$146. This estimate makes up 914.2 billion soums (\$ 821.6 million).
2. Cost estimate of the demand based on loan amount equivalent to \$500. According to the results of sociological poll, right now about half of MFO clients wanted to receive this very size of microloans. In this case, cost estimate makes up 3,131.1 billion soums (\$ 2,813.8 million).

### ***Short-term outlook: the first cost estimate***

The aggregate current demand for financial resources in Uzbekistan is about 914.2 billion soums. It is a rather significant sum, which is equal to 5.8% of the forecasted level of Uzbekistan's GDP in 2005. At present a total of all financial institutions operating in the country meet only 9.2% of the current demand.

As of the beginning of May 2005, non-government non-commercial microfinance organizations (NGO-MFO) have issued microcredits in the amount of 4.2 billion soums (\$3.9 million) that amounts to only 0.5% of current demand or 0.04% of GDP in 2004.

After adopting legislative measures proposed in the report to encourage the development of microfinance organizations (MFO), it is planned to increase the credit portfolio of MFOs up to 15.5 billion soums, or 0.1% of GDP by the end of 2005. In order to achieve this goal, based on the average number of clients per MFO currently equal to 2,000 people, 21-22 new microfinance organizations must be established. Thus, the total number of MFOs should reach 35-36 organizations.

### ***Medium-term outlook: the second cost estimate***

In order to meet the demand for microfinance services in the medium-term it is planned to bring the volume of microcredits issued by MFOs to 100 billion soums in total by the end

<sup>54</sup> Central Bank exchange rate as of June 2005 (USD 1 =1112, 75 soums).



of 2008. That sum will amount to 10.9% of the current demand by the first cost estimate, or about 3.2% of demand by the second cost estimate. Thus, meeting the demand in the medium-term outlook should occur as a result of opening new MFOs (increase the number of clients and average loan size of microcredits) and improving the quality of services provided by existing MFOs. In order to achieve the goal of an average number of clients per MFOs at 3,000 people and average size of credits equal to \$500, it will be required to establish 43 MFOs in addition to the existing 35-36 MFOs by the end of 2005. Thus, the total number of MFOs should reach 78-79 organizations by the end of 2008.

### ***Prospects of MFOs' relations with commercial banks***

During the current quantitative stage of development in the microfinance sector, banks and MFOs act independently from each other with no competition yet taking place between them. Excessive banking regulations, however, may be capable of pushing MFOs towards the bank-dominated market. Vice versa, and with special regards to collateral requirements, a reduction in the regulatory reach of the Central Bank may be an incentive for banks to more actively participate in the microfinance services market. Answers by poll respondents prove it, which leads one to conclude that bank loans correspond to notions about acceptable credit from the perspective of amount, interest rates, and period of repayment. However, the complex procedures of receiving bank microcredits force entrepreneurs to seek funds in non-bank organizations (CU and MFO) despite their extremely high interest rates, short periods of crediting, and small loans.

In the meantime, MFOs and banks may create partnerships in certain areas. For instance, banks may provide loans to MFOs for subsequent retailing of microloans. They can also be partners in minimizing the costs and seeking new clients.

Banks will not operate in the microfinance sector because of high transaction costs, and MFOs cannot currently offer larger loans because of a lack of financial resources. Analysis indicates that the niche of credits from 500 to 3,000 dollars will remain underdeveloped and potentially significant for a long time to come.

As it was mentioned earlier, microcredits do not make any positive impact on those entrepreneurs whose expenses are under \$500 per month. It means that a special credit product must be developed to enable them to increase their monthly business investments to a minimum of 1,500 US dollars. It is clear that only MFOs can potentially provide such a product (Appendix 1, picture 5: Cluster distribution of entrepreneurs based on their level of business expenses and profit margins). The development of such product is of great importance and urgency for Uzbekistan.

### ***The impact of microfinancing on the development of the financial sector of the economy***

Through the attraction of small entrepreneurs into the financial sector it is possible to decrease the out-of-bank turnover of money resources by means of providing individuals with access to MFO capital. The monetary policy of the Central Bank will become more effective, banks will be able to credit businesses in market terms, and the reduction of a shadow economy will result in an increase in tax collections into the state budget.

Microfinancing has already begun to form a new segment in the financial market. Survey results have shown that there is a segment of micro entrepreneurs in the country who have developed themselves without resorting to any banking services. 10% of entrepreneurs are sure that banks do not issue small credits at all, 14% of respondents did not use banking services during their business activity, and 38% of respondents had not used banking services within the last two years. Thus, microfinancing became an underpinning for the formation of a new segment of the financial market which operates exclusively based on market principles

and accelerates the growth of financial mediation in the country and the diversification of the savings and loans market as a whole.

Microfinancing establishes a new culture of savings. The principle of forming an obligatory savings within the programme framework for group microcrediting allows the prompt accumulation of a significant savings volume. Subject to the organization of microfinance movements on a nation-wide scale, the given plan for forming savings can become a new and stable component of investment programmes.

### ***The impact of microfinancing on solutions to social issues***

Every social aspect of microfinancing is important for Uzbekistan, considering the current demographic tendencies and increasingly stiff labour market<sup>55</sup>.

Microfinancing has attracted more than 70 thousand clients. Analysis has shown that entrepreneurs working in microcrediting programmes recruit on average 2-3 family members in their businesses. It means that additional employment has been provided for 200 thousand people in Uzbekistan.

The financial sector of the country also lacks serious gender inequality. In a recent survey 71% of respondents answered that difficulties associated with receiving of a credit did not depend on the sex of the borrower, while 22,5% of respondents believed that it is easier for women to receive credit. The survey also showed that entrepreneurial women always recruit female employees and they tend to recruit the women in their families.

There is a special interest in assessing the access of poor groups to MFO loans. Unlike commercial banks and CUs, MFOs actively and organizationally seek to increase employment and incomes. In practice MFO credits are not only more accessible but seem to defy the urban/rural divide and thus allow for a levelling off of regional social inequalities.

Taking into account the low mobility and challenging employment problems of the agrarian labour, it is most likely that microfinancing here can serve as a long-term, fundamental and effective tool to reduce the acuteness of social problems.

### ***New pilot projects***

Two types of new pilot projects will strengthen the status of microfinancing in Uzbekistan: pilot testing of new microfinance products and the introduction of traditional microfinance products in areas with the most difficult job market situation.

The introduction of microinsurance schemes may become one of the former pilot project types. Analysis shows that, due to their size, microcredits are highly apt for microinsurance purposes and many MFOs are interested in providing these services to their clients but are not able to implement it within the framework of current legislation. Pilot projects of this type can be implemented within the framework of regional development strategies currently in the works. Furthermore, regions covered by these strategies, except for Bukhara and Khorasm regions, initially served as a foundation for the introduction of microfinancing by international organizations and donors. It means that the established microcrediting base is sufficient for the approbation of corresponding microinsurance schemes.

As a basis for the second type of pilot projects, estimates of the Ministry of Labor and Social Welfare's 2005-2006 forecasted parameters may be used in 51 areas of the country

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<sup>55</sup> Due to the high birth rate and demographic burst of the 1970-80s, the labor market of Uzbekistan annually increases by about 0.8 million people while not more than 0.12 million people leave it. Youth from the countryside constitute about 400-500 thousand people in the overall growth in the labor market.

which exhibit difficult job markets situation. The introduction of pre-tested microcrediting schemes will be carried out much faster here and will have a rapid social effect.

### ***Prospects of donor support to MFOs***

Donor organizations can provide long-term assistance and resources required for the establishment of organizations capable to work without donor support. They can also offer and exit strategy. Increases in efficiency and stability of MFOs can be achieved through:

- Technical assistance;
- Improvement of legislative and regulatory framework of microfinance process;
- Facilitating the regulation of microfinance from the perspective of its integration into the wider financial sector<sup>56</sup>;
- Development of reporting standards, transparency, and performance indicators in the developing industry;
- Improvement of professional skills of MFO staff on risk evaluation, accounting, financial management, internal control, auditing and reporting;
- Improvement of professional skills of MFO management in monitoring and financial liability;
- Facilitate MFO innovations for broader coverage of poor population groups
- Assistance in transformation of NGO-MFOs into sustainable organizations. They could start with the transformation of advanced NGO-MFOs into deposit-accepting and regulated MFOs such as microfinance banks;
- Financing establishments of small start-up innovative venture enterprises;
- Investment into more labour-intensive business related to the broader MFO capacity.

### ***Prospects of MFO merger***

In long-run the stronger MFOs with established client bases and market shares could benefit from reorganizing into fully functional regulated financial organizations capable to offer their clients a wider range of services.<sup>57</sup>

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<sup>56</sup> Taking into account that microfinance services may be provided by various institutions.

<sup>57</sup> The example of this is the merger of two NGO-MFOs undertaken with support of Support programme for development of mountain settlements (SPDMS) and Fund of entrepreneurship support in Tajikistan, that resulted in the establishment of a licensed microfinance bank (with support of IFC).

In Mongolia, “HAS” NGO-MFO has merged with Govin Ekhel (Mercy Corps) that resulted in establishment of financial company that later has been reorganized into “HAS” bank.

In Cambodia, “The association of local agencies of economic development” (ALAEDC) has been reorganized from an NGO-MFO into a bank, thanks to considerable aid from donors. The initial NGO has delegated its assets and obligations on long-term credits provided by donors to the new AMAERK bank. At the moment of reorganization the NGO retained 45% of ownership capital, and foreign investors bought 49% of shares of the new bank. At present AMAERK has more than 85 thousand clients.

In the Philippines, after six years of successful activity as an NGO-MFO, the Centre of Agricultural Development (CAD) became the first organization in the country that has been reorganized into an agricultural bank. It became possible as a result of long-term support by donors and insistent efforts of CAD on establishing the government position on this issue that resulted in obtaining government support for this reorganization. By the end of the first year of activity, the number of active members increased by 90%, the number of active credits increased by 70%, and the total amount of the credit portfolio has grown by 134%. Despite such rapid development, the indicator of credit repayment ability remained very high, averaging 98-99%.

In Armenia, “The catholic assistance service” and “Help the children” (USA) have merged and

Small-sized MFOs with a low level of capitalization in most cases will not be able to continue their activity without regular subsidies. Consolidation by merger of small-sized MFOs, where fixed costs, such as surcharges, expenses for staff, equipment and training can be consolidated would promote the strengthening of these organizations.

## **Conclusion**

The well known social aspects of microfinancing are particularly important for Uzbekistan, considering the current demographic tendencies, the increasingly tough job market and increased social tension.

**1. Solution to employment problems.** The entrepreneurs working under microcrediting programmes recruit on average 2-3 family members into their businesses. Microfinancing has already attracted more than 70 thousand clients, and thus has provided about 200 thousand people with employment in Uzbekistan. Taking into account the low mobility and challenging problems of employment in the agrarian labour as well as Uzbekistan's high birth rate, it is most likely that microfinancing here can serve as a long-term, fundamental and effective tool to ameliorate social problems.

**2. Emergence of middle class owners** – The underpinning of socio-political stability in any country. Analysis has shown that bank credits most effectively increase sustainability and the rate of return on microbusinesses. With the help of microcredits, 71% of clients of MFOs increased their turnover, while 60% of clients increased their profits.

**3. Microfinance organized and supported by the government reduces the appeal of underground alternative financing schemes, especially those with religious and extremist backgrounds.**

Events of the recent years show that organizations of religious nature may gain a moral and psychological advantage over the government within a short time-span. Today methods of fighting against them exclusively by force are not sufficient. It is necessary to organize the powerful alternative process of state resistance, and in this sense, the importance of micro financing can hardly be overestimated.

**4. The organization of the process does not require a large financial commitment by the state,** since it is implemented on the conditions of urgency, finance charges, and repayment. It is important that micro financing can address problems wherever official state programmes fail: small trade, small businesses and agricultural production, particularly, livestock farming, and services.

**5. Emergence of a new culture of savings.** The principle of forming mandatory savings within programmes of group microcrediting allows the rapid accumulation of considerable amount of savings. In organizing the microfinancing movement on the national scale this scheme of forming savings may become a new and stable component of investment programs.

**6. Ameliorate the problems related to cash circulation** by reducing cash turnover bypassing banks. Micro credits are rendered in cash from deposits by an organization's own clients, who are eligible to receive the new credit only after returning the previous one. 75% of microfinancing programme clients apply repeatedly for credits without applying to banks.

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established the Fund for the development of microenterprises (FDME) Camurge in 2000. FDME allocates credits to female groups from 50 to 250 US dollars and it is financially stable.

In Kyrgyz Republic, the organization "Bay Tushum" was established in 2000 by merger of ACDI/VOCA and "Karitas" credit programmes.

Wide-scale introduction of microfinancing may serve as a stabilizing factor for cash circulation.

**7. Forming a new segment of the financial market.** Survey results show that there exists in the republic a segment of micro entrepreneurs who have grown up operated without ever applying for banking services: 14 % of respondents had never encountered banks in the entrepreneurial activity, while 38 % had not approached banks during the last two years. Forming a new segment of financial market, which functions exclusively based on market principles, microfinancing accelerates the growth of financial mediation in the country and the diversification of the savings and crediting market as a whole.

**8. Microfinancing serves as the most modern tool for effective implementation of institutional reform pursued in the agricultural sector.** The restructuring of shirkats, or collective farms, into private farms brings about a substantial demand for small credits. In 2004-2006 1,020 collective farms or 55 % of their total number are expected to be restructured into farms. New small farmers will direly need small funds for the development of their farms, the purchase of machinery, seeds, and fertilizers. Demand for small credits will be very high, given the fact that over 60 % of the population lives in rural areas.

**9. Micro financing is an important instrument for the decentralization.** Decentralization will become an important factor for developing microfirms, which require small credits to develop and diversify their production, while banks are not able to meet their demand.

Thus, today micro financing is the most practical opportunity to improve the social and economic well-being of a substantial part of Uzbekistan's population and to reduce the acuteness of social tension in society.

At the present stage, the main factor concerning the implementation of all the aforementioned aspects of microfinancing is the elaboration of the state programme for its support in facilitating social and economic developments of the country. Such a programme should include the following components:

**1. Elaboration of legislative and regulatory framework.** Further development of the legislative and regulatory framework of micro financing should take place in two stages:

- Adoption of the Resolution by the Cabinet of Ministers to address most urgent basic problems of MFO: clear registration procedure for various types of MFO, determining the MFO access to alternative sources of financing and procedures for further taxation.
- Development of the law "On Microfinancing in the Republic of Uzbekistan" to identify the complete spectrum of issues related to the activities of MFOs in Uzbekistan. Adoption of this Law will make the most positive impact on the micro financing sector in terms of forming an optimal legal framework.

**2. Extension of tax preferences.** Taking into account the early stage of development of the microfinancing sector and its special social significance it seems reasonable to extend the privileged regime of MFOs' income taxes for the next three years. Concurrently, services to provide microcredits and microleasing should be exempt from the value added tax.

The conditions for extension should include the targeted use of deductible funds to further provide for microfinancing services, coverage of transaction costs of MFOs, and the development of their material and technical infrastructure. It is noteworthy that in the past banks were also provided income tax privileges, which played an important role in formation of the national bank sector.

**3. State participation.** The state may allot funds for establishing targeted MFOs. For example, it is possible to allocate state loans for the most vulnerable strata of the rural

population – rural teachers, doctors, technical and engineering employees, young families, and so on, and attract MFOs to administer these funds. Requirements to expand the geographical reach of MFOs to all regions of the country should become the main precondition for receiving a loan.<sup>58</sup>

4. *New pilot projects.* Two types of new pilot projects will strengthen the status and scale of microfinancing in Uzbekistan: pilot testing of new micro financing products and the introduction of traditional microfinancing products in regions where the labor market is most tense.

5. *Raising public awareness.* One cause for the small number of organizations involved in microfinance and the resulting lack of competition is a lack of information. Raising public awareness of microfinancing is possible by holding various round-tables, MFO activity presentations, implementing joint MFO initiatives in conjunction with state bodies, releasing booklets, brochures, and manuals on microfinancing, as well as broadly covering the phenomenon in the national media.

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<sup>58</sup> Current microfinance programmes are limited mainly to Karakalpakistan, Kashkadarya province, and regions in the Ferghana valley.

**Brief outcomes of a sociological survey of MFOs and their clients  
(Tahlil Center of Social Research)**

According to the concept and tasks of social research, several target participant groups were selected:

- Entrepreneurs – members of bank and non-bank microcredit programmes;
- Potential participants of bank and non-bank microcredit programmes among SME sector representatives;
- Bank managers involved in microcrediting and the staff of non-bank microfinance institutions, including donor organizations;
- Staff of government bodies for supervision and control.

In selecting a sample for the quantitative survey and in-depth interviews, a special focus was placed on gender aspects of microfinance and access issues for poor population groups.

The survey was conducted in March/April 2005. A combined approach which utilized quantitative and qualitative methods of data collection was selected. A survey of 620 respondents was conducted by quota sampling during the course of the quantitative stage. Quotas were formed based upon indicators important to the study's goals:

- Types of MFIs where respondents were issued microcredits (banks, CUs, MFOs);
- Types of microcredit products offered (preferential and commercial bank credits, microcredits of non-budget funds, foreign credit lines, group and individual loans, MFOs and CUs, including non-cash);
- Activities of microcrediting programme participants – clients of banks, MFOs, and CU members (manufacturing, agriculture, services, trade, etc.).

Quotas for SME entrepreneurs who had not received microcredits were formed for the assessment of needs in microcredit products. A database of the quantitative stage of research is available in SPSS and DBASE formats for subsequent analysis.

In the course of the qualitative research 48 in-depth interviews were conducted including 8 interviews with key stakeholders:

- Bank managers involved in microcrediting and the staff of non-banking MFI, including donor organizations;
- Staff of government bodies for supervision and oversight of the operations of credit institutions (Central Bank, tax inspection, justice department, etc.);
- Participants of bank and non-bank microfinance programmes.

The processing of information received in the course of in-depth interviews was conducted with the use of advanced methods of coding qualitative information.

8 case-studies involved the credit histories of non-bank microfinance institutions.

Based upon the localization of existing microfinance programmes, the survey was held in 5 regions of Uzbekistan: Kashkadarya, Namangan, Samarkand, Tashkent, and Ferghana regions.

*A full version of the results of the sociological survey of the MFO sector is available at the  
Center for Economic Research*

**Table 1. Average per capita income of respondent families in March 2005**

	Average income, thou. soums	Share of families with average per capita income of 25,000 soums, %	Share of families without money income %
<b>Total</b>	60,7	78,3	2,2
Kashkadarya region	62,6	86	-
Ferghana region	48,2	77,3	4
Samarkand region	42,7	80	4
Tashkent region	88,3	70	0,7
Recipients of bank loans	39,8	80,5	3,3
Recipients of CU loans	101,5	62,7	2,7
MFO borrowers	54,7	86,1	0,6
Did not apply for loan	49,8	86,7	1,7
Trade	79	77,7	1,4
Catering	32,9	84,6	-
Manufacturing non-food goods	35,8	83,9	-
Production of food stuffs	38	77,8	-
Farming and processing of agricultural produce	55,6	76,6	4,8
Services	56,7	80	-
High operating profit margins	1146,2	62,8	-
Low operating profit margins	40,6	82,8	2,4
Operating revenues	33,2	88,6	4,6

**Table 2. Distribution of respondents by occupation and entrepreneurial status, %**

	Share of those running a business	Legal entities among those running a business	Working with patents among those running a business	Unregistered business
Trade (except for buy/sell of cattle)	42,7	22,3	41,0	36,7
Farming (except cattle/poultry)	17,5	63,8	-	36,2
Farming/sale of cattle/poultry	29,5	15	15	70
Production of foodstuffs from own raw materials	2,2	15,4	23,1	61,5
Production of foodstuffs from purchased raw materials	6,3	26,3	39,5	34,2
Manufacturing non-food products	11	37,9	28,8	33,3
Construction	3,5	85,7	4,8	9,5
Services and catering	11,8	46,5	38	15,5

**Table 3. Number of staff in surveyed microenterprises**

	Average number of employees, persons	Share of family members among the employees, %	Average number of employed women, persons	Average number of employed women – family members, persons
<b>Total</b>	<b>4,8</b>	<b>43,8</b>	<b>1,8</b>	<b>1</b>
Kashkadarya region	6,5	27,7	1,5	0,8
Ferghana region	3,7	56,8	1,5	1
Samarkand region	6,7	37,3	2,8	1,1
Tashkent region	2,7	74,1	1,4	1,1
Trade	2,6	65,4	1,1	0,9
Catering	6,5	36,9	3,5	1,4



Manufacturing non-food products	9,7	21,6	3,2	1,3
Production of foodstuffs	3,8	60,5	1,8	1,2
Farming and processing of agricultural produce	5,4	48,1	2,2	1,1
Services	7,2	25	1,1	0,6

**Table 4. Average income, costs and profit of microentrepreneurs in March 2005**

	Share of respondents, who did not have revenues this month, %	Average income, thou. soums	Ratio of costs against revenues, %	Average profit thou. soums	Share of respondents, who did not make profits, %
<b>Total</b>	<b>16,2</b>	<b>1500</b>	<b>112,9</b>	<b>234</b>	<b>19,8</b>
Kashkadarya region	15,3	2244	90,7	311	17,3
Ferghana region	9,3	1465	172	221	13,3
Samarkand region	22,7	1629	106,7	291	29,3
Tashkent region	17,3	652	74	120	19,3
Trade	4,6	1382	141,9	204	5,9
Catering	-	1151	132,1	177	15,4
Manufacturing non-food products	3,2	824	127,6	174	8,1
Production of foodstuffs	5,6	957	136,5	254	5,6
Farming and processing of agricultural produce	35,9	1272	68,3	233	42,1
Services	13,3	3775	120,4	426	15

**Table 5. Distribution of costs of microenterprises in March 2005**

	Average costs, thou. soums	Share of respondents who incurred expenses, %	Share of expenditures in the average cost structure of entrepreneurs, %
Working capital	1441	94,2	76,6
Fixed costs	552	6,7	2,2
Wages	184	38	4,3
Space rental and utilities payments	61	29,3	1,1
Transport costs	69	76,7	3,2
Taxes, fees, and dues	300	33,8	5
Payment for patent	35	28,5	0,6
Informal payments	61	6,5	0,2
Bank loan payments	198	29,7	3,6
Loan payments to credit union	143	17,3	1,5
Loan payments in MFO programme	49	18,3	0,6
Repayment of operating debts to individuals	183	3	0,3
Other costs	121	11,3	0,8

**Table 6. Evaluation by entrepreneurs of their profit margins for the last 6 months, %**

	High operating revenues	Low operating revenues	Operating income barely covers the costs
<b>Total</b>	<b>28,7</b>	<b>49,5</b>	<b>21,8</b>
Kashkadarya region	36	41,3	22,7
Ferghana region	30	42	28
Samarkand region	26	62,7	11,3
Tashkent region	22,7	52	25,3

Urban	37,1	43,5	19,4
Rural	20,3	55,5	22,3
Male entrepreneurs	25,8	49,9	24,3
Female entrepreneurs	32,4	49	18,5
Recipients of bank loans	27,1	50	22,9
Recipients of CU loans	30	44,7	25,3
MFO borrowers	29,4	52,2	18,3
Non-recipients of microloans	28,3	51,7	20
Trade	30,9	49,1	20
Catering	7,7	53,9	38,5
Manufacturing non-food products	22,6	62,9	14,5
Production of foodstuffs	41,7	44,4	13,9
Farming and processing of agricultural produce	26,8	48,3	24,9
Services	30	43,3	26,7

**Table 7. Main issues faced by microentrepreneurs, %**

High taxes	88,0	Problems of high cost of resources and deductions from working capital
Inaccessibility of essential equipment and materials (too expensive)	80,7	
High operating costs	38,5	
High costs of transport services	38,5	
Expensive fuel and lubricants, feeds, fertilizers/ not available in free sale	10,4	Problems of banking system and lack of access to loans
Difficulties of getting a loan	58,9	
Lack of money and working capital	55,7	
Difficulties of access to cash in banks	50,0	
Difficulties in banking	27,6	Bureaucratic procedures and harassment
Lack of legislative and regulatory acts to regulate non-bank microfinance organizations and credit unions	11,5	
High loan interest	5,7	Issues of sale and competition
Excessive checks hindering work	24,0	
High informal payments (bribes) to the officials	17,2	Problems of staff and information shortages
Extensive and labour intensive procedures for reporting in government institutions	15,1	
Intensive competition	39,1	
Sale issues	30,7	
Shortage of experienced and honest staff	29,2	
Lack of information about new statutory acts	22,9	
Lack of knowledge and experience in running business	13,5	

**Table 8. Distribution of microcredit recipients by various forms of credit organizations, % of the clientele of credit organizations**

	Bank clients	CU clients	MFO clients	Did not take loans
Trade	25,2	35,3	55,6	23,3
Services and catering	15,2	10,7	1,7	36,7
Manufacturing non-food products	11,9	8	8,9	15
Production of foodstuffs	3,8	7,3	7,2	6,7
Farming and processing of agricultural produce	43,8	38,7	26,7	18,3

**Table 9. Terms for getting microcredits in 2004, % of the number of clients of all credit institutions**

	Average loan amount (thou. soums)	Average monthly interest rate	Average loan maturity (months)	Average amount of loan payments (thou. soums per month)	Average final amount of loan payments (thou. soums)	Comments: Main factors lowering economic efficiency of a loan
In bank	3 500	2	21	70	1 470	<ul style="list-style-type: none"> <li>• High transaction cost of a loan;</li> <li>• Non-cash form;</li> <li>• Informal payments (10-20 percent of loan amount);</li> <li>• Tranche system of crediting</li> <li>• Period of review of loan application</li> </ul>
In CU	1 100	6	7	66	462	High transaction cost of credit
In MFO	220	5	5	11	55	Monthly repayment of a loan

**Table 10. Forms of collateral, % of client numbers**

Forms of collateral	In a bank	In CU	In MFO
Without collateral	0	3,7	94,0
Jewelry	4,7	24,5	0,3
Housing	5,6	6,1	0
Agricultural land	0,9	3,7	0,6
Cattle	5,1	1,2	0,3
Office/manufacturing space	20,1	10,4	0
Transport	43,5	26,4	2,3
Agricultural equipment	15	12,3	2,6
Guarantees of insurance company	6,5	0,6	0
Guarantee of private firm	12,6	3,1	0
Deposit	0	8	-

**Table 11. Changes in business after getting a microloan in 2004, % of the number of clients**

	Bank clients	CU clients	MFO clients
Increase in turnover	45,7	38,7	71,1
Increase in profits	46,7	42,0	56,1
Opening of new business	3,3	5,3	1,1
Business for other family members	1,4	4,0	3,9
Improvement in family budget	21,4	36,7	31,1
Increase in family savings	8,6	9,3	6,7
Business as main operations	4,8	4,0	5,6
Nothing has changed	10,5	10,7	10,6

**Table 12. Use of microloans by entrepreneurs willing to take microloans in 2005**

	Banking microloans		CU microloans		MFO microloans		Entrepreneurs who have not taken microloan in 2004
	How used	How would like to use	How it was used	How would like to use	How it was used	How would like to use	How would like to use
Investment into working capital	35	6	23	7,8	46	27,5	8,6
Investments into fixed assets to expand business	59	72,0	68	76,5	50	57,5	57,1
Start-up capital/launching a new business	9	25,3	14	26,1	3	14,4	40,0
For family needs	1	3,3	6	3,5	3	6,0	2,9

**Table 13. Distribution of entrepreneurs by loan amount essential to run a business, %**

	500 thou. soums and less	600-1,000 thou. soums	1,200-3,000 thou. soums	3,500-5,000 thou. soums	6,000-10,000 thou. soums	More than 10,000 thou. soums	Average loan amount
Trade	31,1	23,0	18,6	10,4	9,8	7,1	4700
Catering	0	0	44,4	33,3	11,1	11,1	5300
Manufacturing non-food products	22,4	8,2	14,3	16,3	28,6	10,2	18100
Production of foodstuffs	48,1	11,1	18,5	18,5	3,7	0	1900
Farming and processing of agricultural produce	14,9	14,3	27,9	17,5	18,2	7,1	5200
Services	13,3	8,9	22,2	17,8	15,6	22,2	11200
<b>Total</b>	<b>23,6</b>	<b>16,1</b>	<b>22,1</b>	<b>15,0</b>	<b>14,8</b>	<b>8,6</b>	<b>6750</b>

**Table 14. Distribution of entrepreneurs by the preferred loan maturity period, B %**

	Up to 6 months.	6 mo	7-10 mo	1 year	1,5 - 2	2,5 - 3	3,5 - 5 years	Average loan maturity (mo)
Trade	9,3	15,8	10,4	27,9	20,2	13,1	3,3	17
Catering	0	11,1	0,0	33,3	44,4	11,1	0	19
Manufacturing non-food products	8,2	12,2	2,0	18,4	16,3	30,6	12,2	26
Production of foodstuffs	14,8	22,2	7,4	25,9	11,1	18,5	0	15
Farming and processing of agricultural produce	3,2	7,1	1,3	20,8	22,7	33,8	11	27
Services	2,2	2,2	4,4	35,6	26,7	22,2	6,7	23
<b>Total</b>	<b>6,6</b>	<b>11,6</b>	<b>5,6</b>	<b>25,3</b>	<b>21,2</b>	<b>22,9</b>	<b>6,9</b>	<b>22</b>

**Table 15. The highest interest rate for loan that entrepreneurs are currently prepared to pay depending on operating profit margin, in %**

	up to 1%	1%	2%	3%	4%	5%	6-6,5%	7-10%	Average loan interest rate
Bank clients	22,7	24,0	42,7	8,0	1,3	0	0	1,3	1,5
CU clients	5,2	6,1	20,9	25,2	10,4	15,7	13,9	2,6	3,5
MFO clients	3,0	9,6	10,8	12,6	32,9	3,6	25,1	2,4	4
Have not taken a microcredit	14,3	17,1	31,4	14,3	0	11,4	2,9	8,6	3
Trade	3,8	11,5	23,0	17,5	19,7	6,6	14,2	3,8	3,5
Catering	0	22,2	44,4	22,2	0	0	0	11,1	3
Manufacturing non-food products	12,2	30,6	18,4	10,2	8,2	6,1	14,3	0	2,5
Production of foodstuffs	7,4	0	3,7	18,5	18,5	3,7	44,4	3,7	4,5
Farming and processing of farm products	21,4	12,3	29,9	11,0	11,7	5,8	7,1	0,6	2,5
Производство услуг	4,4	17,8	33,3	13,3	13,3	6,7	6,7	4,4	3
<b>Total</b>	<b>10,7</b>	<b>13,9</b>	<b>25,1</b>	<b>14,3</b>	<b>14,8</b>	<b>6,0</b>	<b>12,6</b>	<b>2,6</b>	<b>3</b>

**Table 16. Impact of microcredit terms on entrepreneur's willingness to take a microcredit, in % of sample**

	Would rather take a loan at these terms	Would rather not take a loan at these terms
Interest rate 1-2% per month	94,6	4,9
Interest rate 3-6% per month	45,4	52,2
Loan amount up to 500 USD	34,0	63,4
Loan amount 500-1500 USD	56,5	41,3
Loan maturity less than 3 months	16,5	80,7
Loan maturity from 3 to 6 months	35,3	64,0
Loan maturity from 6 to 12 months	76,7	21,0
Requirement to provide collateral in amount of 120% of cost of microcredit	57,8	34,5
Возможность получения кредита наличными	91,9	7,9
Assessment of collateral property below its market price	46,9	44,1
Requirement to become a member of credit organization to get a loan	55,9	36,8
Requirement of good credit history	56,1	19,9

**Table 17. Entrepreneurs' assessment of the operational efficiency of various microcredit institutions**

	Share of unaware entrepreneurs In percentage of sample		Assessments of informed entrepreneurs, percentage of the informed	
	Does not know that this organization issues microcredits	Never dealt with this organization/does not know of this organization	Probably good	Probably bad
Banks	10,5	14,2	60	40
Credit line of Employment Promotion Fund	19,7	55,2	63	37
Credit lines of international organizations	13,5	59,3	73	27
Business Fund	17,5	55,2	30	70
Fund for Support of Farmers	21,0	55,3	31	69
CUs	14,8	53,0	83	17
Programmes for NGO microcrediting	13,0	45,2	91	9

**Table 18. Difficulties that entrepreneurs encounter in getting microcredits of various institutions, percentage of sample**

	At banks	At CU	At MFO
Period and difficulties of loan approval	34,3	3,3	12,8
Large collateral	48,6	13,3	1,1
Difficulties in access to cash	48,6	2,7	12,2
Very small amount of loan	19,1	17,3	34,4
High interest rate	47,1	58,7	20,6
Loan maturity period is too short	29,1	28	25,6
Bribes	14,3	2,7	1
Not allowed to repay the loan before maturity period	9,5	2	4,4
Long period of loan approval after application	9,5	2	4,4
Violation of terms/delays in credit tranches	11,4	1,3	2,2
Remoteness of the organization	14,3	27,3	5,6
Impossible to get a loan to start a business	10	3,3	6,7
Requirement of monthly loan payments	14,7	-	33,9
Requirement to pay into reserve fund	-	3,3	25,6

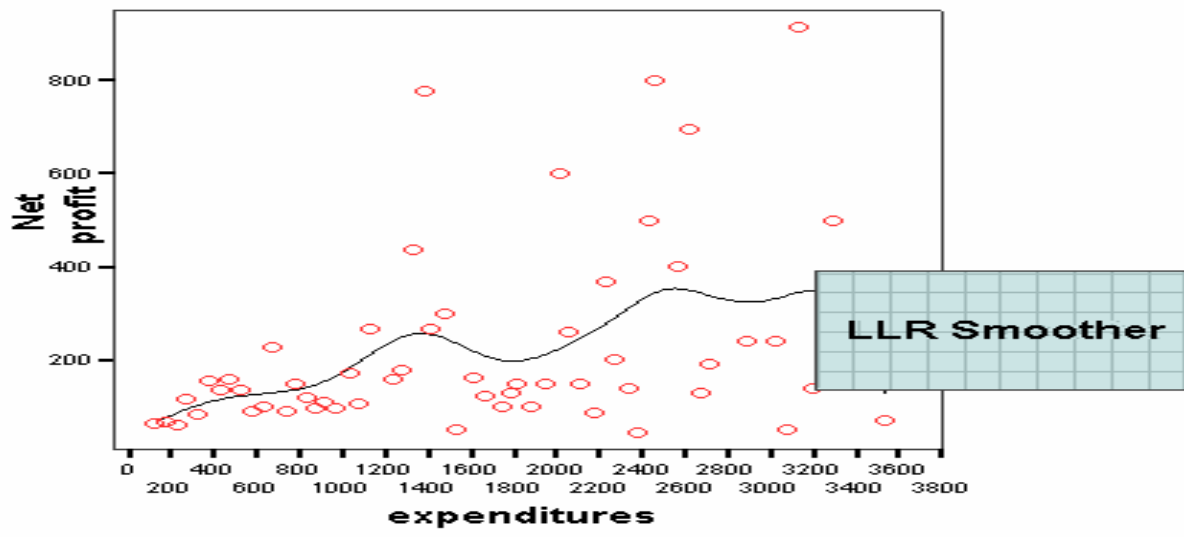
**Table 19. Credit products issued through commercial banks**

	Loan amount	Annual percentage rate	Maturity	Additional terms
<b>Funds for Preferential Crediting from Bank funds</b>				
For legal entities	up to 10,000 USD	Not higher than refinancing rate of Central Bank *	Up to 3 years	Occupational quotas; 50% of loans to dekhkans and private farms are issued and repaid in cash
For individuals	up to 5,000 USD	Not higher than refinancing rate of Central Bank	Up to 3 years	Occupational quotas; 50% of loans to dekhkans and private farms are issued and repaid in cash
<b>Employment Promotion Fund</b>				
for legal entities	300 minimal wages	40-45% of refinancing rate of Central Bank	Up to 3 years	Occupational quotas; creation of no less than 5 jobs
for individuals	150 monthly minimal wages	40-45% of refinancing rate of Central Bank	Up to 3 years	Quotas for types of activities; 50% of loans are issued and repaid in cash
for individuals – family businesses	150 monthly minimal wages	1/6 refinancing rate of Central Bank	Up to 2 years	Deduction to Pension Fund; priority is given to socially unprotected families; grace period up to 6 mo; 50% of loans are issued and repaid in cash
<b>Fund for Support of Dekhkan and Farmers</b>				
Private farms and dekhkans – legal entities	up to 1,0000 USD	1/3 refinancing rate of Central Bank	Up to 3 years	Grace period no less than 2 years; 50% of loans are issued and repaid in cash
Dekhkan farms without status of legal entity	up to 5,000 USD	1/3 refinancing rate of Central Bank	Up to 3 years	Grace period no less than 2 years; 50% of loans are issued and repaid in cash
for legal entities	up to 1,0000 USD	40-45% of refinancing rate of Central Bank	Up to 10years	Occupational quotas; grace period from 2 up to 5 years
for individuals	up to 5,000 USD	40-45% of refinancing rate of Central Bank	Up to 3 years	Occupational quotas; grace period no less than 2 years; 50% of loans are issued and repaid in cash
Start-up capital	Up to 150 monthly minimal wages	1/6 refinancing rate of Central Bank	Up to 3 years	Occupational quotas; no less than 6 months in business; grace period no less than 2 years

**Notes:**

\* The Central Bank's refinancing rate has changed several times from 24% to 16% throughout 2004.

Figure 5. Cluster distribution of entrepreneurs by operating costs and profit margins



THE CABINET OF MINISTERS OF THE REPUBLIC OF UZBEKISTAN

**RESOLUTION**

**On measures for further development of microfinance in the Republic of Uzbekistan**

With a view of further expanding the access to financial services by the subjects of small business and private entrepreneurship, forming the multi-segmented financial market in the republic to promote structural and institutional reforms, as well as strengthening the role of micro-financing in addressing the priority social issues, the Cabinet of Ministers resolves:

1. It shall be defined that micro-financing is allocated on the conditions of repayment, interest rates, and maturity in the amount, not exceeding the sum equal to three thousand US dollars per borrower and micro-leasing in the amount equal to ten thousand US dollars per lessee, as well as rendering consulting services aimed at raising population incomes, stimulating savings and investments by the subjects of small business and private entrepreneurship.

The given conditions and requirements of holding the micro-financing does not apply to the procedure of allocating micro-loans by commercial banks to *dekhkan* and farming entities, individual business people, and other entities of small business practice.

2. It shall be set, that:

The micro-financing organization shall be established as legal entity to render the micro-financing services to the entities of small business, private entrepreneurship, and low-income population;

The micro-financing organization shall be established as:

The micro-loan organization empowered to attract the people's deposits,

The micro-loan organization not empowered to attract the people's deposits,

Non-commercial micro-loan organization.

The micro-loan organization empowered to attract the people's deposits goes through the state registration and activity licensing with the Central Bank of the Republic of Uzbekistan.

The micro-loan organization not empowered to attract the people's deposits and non-commercial micro-loan organization receive the certificate of registration at the Central Bank of the Republic of Uzbekistan.

3. It shall be approved:

The Statute on state registration and order of activity licensing of micro-loan organization empowered to attract the people's deposits in keeping with appendix №1;

The Statute on the order of issuing the certificate of registration of the micro-loan organizations not empowered to attract the people's deposits and non-commercial micro-loan organizations in keeping with Appendix №2.

4. It shall be defined that the micro-loans are allocated in cash and/or non-cash in the national currency of the Republic of Uzbekistan.

The micro-financing organizations shall be empowered in line with established procedures to receive upon the initial request the money funds in the amount, needed to undertake micro-financing within the funds, available in their bank accounts.



The micro-financing organizations undertake operations with cash in keeping with the Regulations of undertaking cash operations with legal entities, approved by the Central Bank and registered with Ministry of Justice of December 17, 1998, №565.

The banks shall be proposed that in conjunction with micro-financing organizations to determine the leftover limits in cash-offices and norms of utilizing cash with account of prognosis volumes of allocating the micro-loans in cash.

5. It shall be defined that the order and procedure of allocating the micro-loans and micro-leasing shall be determined by the micro-financing organizations on their own. In this, the micro-financing organizations, prior to signing the contracts with borrowers, must make them available the detailed information on the dates and schedules of paying off the micro-loans and micro-leasing, forming the sum of interest and commissions, as well as on the cost of other services, if such are available.

6. As founders, Ministry of Labor and Social Welfare, Chamber of Trade and Commerce, Business Women Association of Uzbekistan shall be entitled to facilitate establishment and development of microfinance organizations, including enhancement of their human and institutional capacity.

7. The micro-financing organizations hold the accounting, statistical and other types of bookkeeping in the simplified order.

The Ministry of Finance, Central Bank, the State Tax Committee, the State Committee on Statistics in conjunction with the Ministry of Justice of the Republic of Uzbekistan in a month's time shall work out the simplified order of carrying the bookkeeping by the micro-financing organizations.

8. The Central Bank of the Republic of Uzbekistan shall be recommended that whilst locating the coefficient of the bank capital sufficiency towards the calculation of the total sum of assets, weighted with account of risks, shall include the bank loans, allocated to micro-financing organizations, to the category of assets with medium grade of risk.

9. The micro-financing organizations shall be exempt:

From income taxes until January 1, 2009 on the incomes, gained from micro-financing, targeted use of the relieved funds to cover the operational costs, develop the logistical base, as well as further extend the micro-financing and charter activity.

From the value added tax for allocation of micro-loans and micro-leasing.

10. The micro-financing organizations, already operating up to the time of adopting current resolution, in time of three of months shall file the necessary documentation as to go through re-registration in line with regulations, as stipulated by the given resolution.

11. The Central Bank in conjunction with Ministry of Justice of the Republic of Uzbekistan and other interested ministries and agencies by the end of 2005 shall elaborate and introduce the draft of the Law of the Republic of Uzbekistan "On micro-financing in the Republic of Uzbekistan".

12. The Central Bank, Ministry of Labor and Social Welfare, Chamber of Commerce and Industry, Ministry of Finance in conjunction with Ministry of Justice of the Republic of Uzbekistan in a month's time shall propose on amendments and addenda into the legislation, which flow out of this resolution.

13. The First Deputy Prime Minister of the Republic of Uzbekistan R. S. Azimov and Chairman of the Central Bank of the Republic of Uzbekistan F. M. Mullajonov shall be made responsible to oversee the implementation of this resolution.

## **STATUTE**

### **ON STATE REGISTRATION AND PROCEDURES FOR LICENSING OF ACTIVITIES OF MICROCREDIT ORGANIZATIONS WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

This statute is drafted in accordance with laws of the Republic of Uzbekistan “On the Central bank of the Republic of Uzbekistan”, “On licensing of certain categories of activity”, and determines the procedures of state registration and licensing of activities of microcredit organizations with right to attract the deposits of population.

#### **I. GENERAL PROVISIONS**

1. The microcredit organization with right to attract the deposits of the population is the specialized finance and credit institution established in the form of joint-stock company or limited liability company, that received a license from the Central bank for the right to grant microcredits and microleasing, as well as to provide consultancy services to certain categories of legal entities and physical persons, at the expense of their own and attracted funds, including the funds of donor organizations, international and local financial organizations, other legal entities, and also at the expense of attracting the deposits of the population.

2. The microcredit organizations with right to attract the deposits of the population acquire the legal entity rights from the date of their state registration. The activity of microcredit organization with right to attract the deposits of the population is carried out on the basis of the license.

3. State registration and simultaneous licensing of microcredit organizations with right to attract the deposits of the population are undertaken by the Central bank of the Republic of Uzbekistan.

4. The license to carry out the activity of microcredit organizations with right to attract the deposits of the population is issued for not fixed period.

5. The decision on state registration of microcredit organizations with right to attract the deposits of the population, as well as the decision on issue, termination, revocation, suspension or resumption of validity of license to carry out the activity of microcredit organizations with right to attract the deposits of the population is taken by the decree of Board of the Central bank of the Republic of Uzbekistan.

6. The license transfer to other legal entity shall be prohibited.

#### **II. DOCUMENTS REQUIRED FOR STATE REGISTRATION AND RECEIVINGS OF LICENSE**

7. For state registration of microcredit organization with right to attract the deposits of the population and receiving of the license, the following documents are presented to the Central bank:

a) The application for registration on carrying out of activity of microcredit organization with right to attract the deposits of the population;

b) The protocol of general meeting of founders on establishment of microcredit organization with right to attract the deposits of the population;

c) The charter of or the statute on microcredit organization with right to attract the deposits of the population;

d) The business-plan of activity of microcredit organization with right to attract the deposits of the population;

e) The list of founders with the indication of:

for physical persons:

surname, name, patronymic, passport data, home mailing address, phone numbers;

type of employment, place of work, position (if he/she works);

for legal entities:

full name, mailing address and phone numbers, payment requisites.

The information on all founders (both physical persons and legal entities) on any legal sanctions applied to these persons by court or controlling state bodies during the last five years before submission of the application is provided;

f) The information confirming the availability of equipped cash holding premises, ensuring safety of cash money and adequate conditions for receiving of deposits from the population. The technical solidity and equipping by means of the security-fire signal system of cash holding premises of microcredit organizations with right to attract the deposits of the population should meet the requirements of “Rules regulating the carrying out of cash operations by legal entities”, registered by the Ministry of Justice of the Republic of Uzbekistan on December, 17, 1998, number 565;

g) The bank payment document on payment of a registration fee.

The given list of documents is very comprehensive. The request to provide the documents that are not established by the present Statute is not allowed.

8. The documents are delivered directly by the applicant for state registration to the Central bank or its territorial division or by means of postal service with the notification on their receipt.

9. The applicant bears responsibility in accordance with legislation for submission of doubtful or vitiated data for state registration.

### **III. REGISTRATION FEE**

10. For state registration of microcredit organization with right to attract the deposits of the population, the fee at a rate of one minimum wage established by the legislation is collected.

The amount of fee for consideration of the application is paid into the separate account of the Central bank.

11. In case of repudiation of the applicant for state registration from sent application during the period of consideration of his/her documents, the amount of the paid fee is not reimbursed.

12. In case of refusal in state registration of microcredit organization with right to attract the deposits of the population, the paid registration fee is reimbursed by the Central bank within 3 days.

#### **IV. QUALIFICATION REQUIREMENTS FOR THE HEAD OF MICROCREDIT ORGANIZATION WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

13. The following qualification requirements are set for the head of microcredit organization with right to attract the deposits of the population:

higher education;

work experience of not less than 3 years in a financial sector;

stainless business reputation.

14. The following persons are considered as not having stainless business reputation for the purposes of the present Statute:

persons disqualified to occupy some or another positions at the enterprises, in institutions or organizations during the period established by court;

former heads and members of councils, executive boards, credit committees or audit commissions of credit and finance organizations if it is established by court that the bankruptcy of that organizations has followed as a result of illegal actions of these persons;

persons whose actions have brought financial losses and damage of business reputation of other credit and finance organizations if it is established by court.

#### **V. PROCEDURE OF REGISTRATION AND LICENSING OF ACTIVITY OF MICROCREDIT ORGANIZATION WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

15. The application with all necessary documents for state registration and receiving of the license is being considered by the Central bank within 30 calendar days from the date of receipt of the application and necessary documents.

16. The Central bank considers the submitted documents for the purpose of meeting the requirements of the present Statute and other legal acts.

17. Along with registration of microcredit organization with right to attract the deposits of the population, the license to carry out the activity of microcredit organization with right to attract the deposits of the population is issued in special form in accordance with appendix to the present Statute.

18. The microcredit organization with right to attract the deposits of the population should start to carry out its activity within one year from the date of licensing.

19. After receiving the license, the Central Bank provides the microcredit organization with right to attract the deposits of the population with necessary normative and legal documents regulating the activity of microcredit organizations with right to attract the deposits of the population.

20. The notification on state registration and licensing is sent to applicant in writing within 3 days after making a corresponding decision.

21. The document certifying the state registration, receiving of the legal entity status and right to carry out the activity of microcredit organization with right to attract the deposits of the population is the license to carry out the activity of microcredit organization with right to attract the deposits of the population.

22. The Central bank formalizes the legal case that include the following documents:

the application for registration;

the protocol of general meeting of founders;

the charter of microcredit organization with right to attract the deposits of the population, the title page of which has a mark regarding its state registration, signed by the authorized official of the Central bank, certified by the seal of the Central bank;

the decision of the Board of the Central bank on state registration and licensing of microcredit organization with right to attract the deposits of the population;

the license to carry out the activity of microcredit organization with right to attract the deposits of the population.

23. The legal case is formalized by the Central bank in three copies:

one copy is given on receipt to the head of microcredit organization with right to attract the deposits of the population;

one copy is kept in the Central bank;

one copy is sent to Main territorial department of the Central bank where microcredit organization with right to attract the deposits of the population is territorially located.

24. The state tax is levied for licensing to carry out the activity of microcredit organization with right to attract the deposits of the population:

the state tax is levied at a rate of five times the amount of the minimum wage established by the legislation of the Republic of Uzbekistan;

the state tax is paid into the republican budget.

## **VI. REFUSAL IN STATE REGISTRATION AND LICENSING OF MICROCREDIT ORGANIZATION WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

25. The Central bank of the Republic of Uzbekistan can refuse in state registration and licensing of microcredit organization with right to attract the deposits of the population in the following cases:

failure to supply the complete list of the documents required for state registration of microcredit organization with right to attract the deposits of the population;

inconsistency between the charter and other submitted documents and the legislation;

presence of doubtful or vitiated data in the documents presented for state registration, as well as the groundlessness of the business plan;

unsatisfactory financial standing of one or several founders - legal entities.

26. The notification on refusal in state registration and licensing is sent to applicant in writing within 3 days along with indication of the reasons of refusal and the period during which the applicant, after eliminating the indicated reasons, can submit the documents for re-consideration.

27. The decision on refusal in state registration and licensing of microcredit organization with right to attract the deposits of the population can be appealed against in a court.

28. The re-consideration of documents is undertaken by the Central bank within 10 days from the date of receiving of all necessary documents from the applicant.

## **VII. AUTHORITIES OF THE CENTRAL BANK OF THE REPUBLIC OF UZBEKISTAN ON REGULATION OF ACTIVITY OF MICROCREDIT ORGANIZATION WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

29. The Central bank of the Republic of Uzbekistan establishes obligatory rules for financial transactions, business accounting and reporting for microcredit organization with right to attract the deposits of the population.

30. The Central bank of the Republic of Uzbekistan according to procedures established by the legislation shall:

check accounts and other documents of microcredit organization with right to attract the deposits of the population;

receive the information on activity of microcredit organization with right to attract the deposits of the population;

check the activity of microcredit organization with right to attract the deposits of the population;

provide the microcredit organization with right to attract the deposits of the population with obligatory instructions on elimination of the infringements identified in their activity;

establish qualification requirements for the head of microcredit organization with right to attract the deposits of the population;

suspend, terminate, and revoke the license of microcredit organization with right to attract the deposits of the population.

## **VIII. PROCEDURE OF SUSPENSION, TERMINATION AND REVOCATION OF LICENSE**

31. The Central bank can suspend the license of microcredit organization with right to attract the deposits of the population in the following cases:

identification of infringements of requirements and conditions of the present statute and other legal acts of the Central bank by microcredit organization with right to attract the deposits of the population;

failure to carry out the instructions of the Central bank by microcredit organization with right to attract the deposits of the population;

The decision to suspend the validity of license is passed by the Central bank to microcredit organization with right to attract the deposits of the population in writing along with reasoned substantiation of the decision not later than within three days from the date of its adoption.

The decision of the Central bank to suspend the validity of license can be appealed against in a court.

The Central bank is obliged to establish the period of elimination of the circumstances which led to suspension of the validity of license by the licensee. The indicated period cannot exceed six months.

In case of elimination of the circumstances which led to suspension of the validity of license by microcredit organization with right to attract the deposits of the population, the Central bank is obliged within ten-day period from the date of receiving of confirmative documents to make the decision on resumption of its validity.

32. The validity of the license can be terminated in the following cases:

request of microcredit organization with right to attract the deposits of the population with the application to terminate the license;

liquidation of microcredit organization with right to attract the deposits of the population - from the moment of liquidation or the termination of its activity;

reorganization of microcredit organization with right to attract the deposits of the population - from the moment of its reorganization, except the cases of its transformation;

infringements of requirements and conditions established by the present statute and other legal acts of the Central bank by microcredit organization with right to attract the deposits of the population, namely:

insolvency of microcredit organization with right to attract the deposits of the population, that is the insolvency to carry out the obligations to investors or other creditors;

regular distortion of the accounting data;

establishment of inauthenticity of data on the basis of which the license is given.

failure to eliminate by microcredit organization with right to attract the deposits of the population the circumstances which led to suspension of the validity of license within the period established by the Central bank.

The validity of the license can be also terminated according to court decision.

The validity of the license stops from the date of making decision on the termination.

33. The revocation of the license can be done by the Central bank in the following cases:

request of microcredit organization with right to attract the deposits of the population with the application to revoke the license;

establishment of facts of receiving of the license with the use of false documents.

The license can be also revoked according to court decision.

The decision on revocation is effective from the date of licensing.

## **IX. KEEPING THE BOOK OF REGISTRATION OF MICROCREDIT ORGANIZATIONS WITH RIGHT TO ATTRACT THE DEPOSITS OF THE POPULATION**

34. The Central bank keeps the book of registration of microcredit organizations with right to attract the deposits of the population which should include:

the name of microcredit organization with right to attract the deposits of the population and its location (mailing address), the basic data on organization (names of the head and chief accountant, phone number, bank account details, etc.);

date of state registration and number of the license;

the reasons and date of renewal, suspension and resumption of the validity of the license;

the reasons and date of termination of the license;

the reasons and date of revocation of the license;

identification number of the tax payer;

other data.

Appendix  
to the Statute on state registration  
and procedures for licensing of activities  
of microcredit organizations  
with right to attract the deposits  
of the population

**LICENSE No \_\_\_\_**

to carry out the activity of microcredit organization with right to attract the deposits of  
the population

"\_\_" \_\_\_\_\_ year 20\_\_

Tashkent city

According to the decision of Board of the Central bank of the Republic of  
Uzbekistan from "\_\_" \_\_\_\_\_ year 20\_\_,

the microcredit organization with right to attract the deposits of the population

---

(a full name of microcredit organization with right to attract the deposits of the population)

---

(mailing address and other requisites)

shall be entitled to carry out the activity of microcredit organization with right to attract  
the deposits of the population in accordance with the legislation of the Republic of  
Uzbekistan.

The present license is valid for unfixed period.

The Central bank of the Republic of Uzbekistan can suspend, terminate the validity of  
the present license, or revoke it in the cases established by laws of the Republic of  
Uzbekistan "On the Central bank of the Republic of Uzbekistan" and "On licensing of certain  
categories of activity"

The microcredit organization with right to attract the deposits of the population is  
included into the State book of registration of microcredit organizations with right to attract  
the deposits of the population "\_\_" \_\_\_\_\_ year 20\_\_ under number: \_\_\_\_.

Deputy chairman  
of the Central Bank  
of the Republic of Uzbekistan

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(Name)

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(Stamp)

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(signature)

Series AA № 000000



## STATUTE

### **ON THE PROCEDURE OF ISSUANCE OF THE REGISTRATION CERTIFICATE FOR MICRO-CREDIT ORGANIZATIONS WITHOUT THE RIGHT TO ACCEPT DEPOSITS FROM THE POPULATION AND NONCOMMERCIAL MICRO-CREDIT ORGANIZATIONS**

This Statute is drafted in accordance with the Law of the Republic of Uzbekistan “On the Central Bank of the Republic of Uzbekistan” and determines the procedure of issuance of the registration certificate for micro-credit organizations without the right of attracting deposits from the population and noncommercial micro-credit organizations (hereafter – micro-credit organizations).

#### **I. GENERAL PROVISIONS**

1. The micro-credit organization means a specialized credit institution set up in line with the organizational and legal form envisaged by legislation, which holds the Central Bank's certificate on registration and exercises micro-crediting and provision of micro-leasing as well as performs consulting services to a certain category of legal entities and natural persons at the expense of its own means, funds from private donors and donor organizations, local and international financial institutes and other legal entities only and without the right of attracting deposits of the population.

The non-commercial micro-credit organization is not entitled to distribute income from its activity among its founders and partners and allocates it for implementation of its statutory objectives.

2. The micro-credit organizations obtain the right for microfinancing activity from the moment of their registration.

Registration of micro-credit organizations is exercised by the Central Bank of the Republic of Uzbekistan.

#### **II. DOCUMENTS SUBMITTED FOR REGISTRATION**

3. The following documents are to be submitted to the Central Bank for registration:
- a) the application for registration to exercise the activity of the micro-credit organization;
  - b) the protocol of the founders' general meeting on establishing a micro-credit organization, (in case of more than one founder);
  - c) the statute or provisions of the micro-credit organization;
  - d) a business-plan of the micro-credit organization's activity;
  - e) the list of founders with indication  
- for individuals:

surname, first name, middle name, passport number, post code of home address and telephone numbers.

- for legal entities:

full name, postal address and telephone numbers and bank accounts.

- f) information confirming the presence of equipped cash offices to ensure the safety of ready cash. Technical facilities and equipped means of guard and fire-alarms of cash micro-credit organizations should comply with requirements under “Rules for exercising cash operations by legal entities” registered by the Ministry of Justice of the Republic of Uzbekistan on 17 December 1998 under #565.
- g) Bank receipt on payment of the registration fee.

This list of documents is exhaustive. Demand for submitting other documents not envisaged by this Statute are not admissible.

4. Documents are submitted for registration either by the applicant directly to the Central Bank or its territorial branch or through post with notification of their delivery.

5. For providing false or distorted information to registration the applicant shall be held responsible in accordance with the Law.

### **III. REGISTRATION FEE**

6. For registration of the micro-credit organization a fee at the rate of one minimal wage set by legislation is collected on the day on which the application is submitted.

The sum of fee for consideration of the application is deposited to a special account of the Central Bank.

7. In case of the applicant’s repudiation from the submitted application during the period of considering his documents, the sum of the paid fee shall not be refunded.

8. In case of refusal to register the micro-credit organization the Central Bank refunds the paid registration fee within three days.

### **IV. PROCEDURE OF REGISTERING THE ACTIVITY OF MICRO-CREDIT ORGANIZATION**

9. The Central Bank deals with an application together with all necessary documents for registration within 15 days from the day on which the application and necessary documents are submitted.

10. The notification on registration is given to the applicant in a written form within 3 days after adopting the relevant decision.

11. The document certifying the registration and the right to exercise the micro-financing activity is the certificate on registering the micro-credit organization in a form conforming with the Appendix to this Statute.

12. The Central Bank formalizes a legal case that includes the following documents:
- the application (petition) for registration;
  - the protocol of the founders’ general meeting;

the statute of the micro-credit organization whose title-page bears the note of registration signed by an authorized official from the Central Bank and attested by the seal of Central Bank.

13. The legal case is executed by the Central Bank in three copies:

one copy is handed over to a Head of the micro-credit organization;

one copy is kept at the Central Bank;

one copy is sent to the Main territorial branch of the Central Bank located in the vicinity of the micro-credit organization.

#### **V. REFUSAL TO REGISTER THE MICROCREDIT ORGANIZATION**

14. The Central Bank of the Republic of Uzbekistan may refuse to register the micro-credit organization in the following cases:

non-submission of the complete list of documents necessary for registration of the micro-credit organization;

unconformity of the statute and other submitted documents to legislation;

presence of false or fraudulent information in documents submitted for registration.

15. Notification on refusal to register is given to the applicant within three days in a written form with indication of reasons for refusal and data, during which the applicant, having eliminated the said causes, may submit the documents for review.

16. The decision to refuse the registration of the micro-credit organization may be appealed to the Court.

17. The Central Bank reviews the documents within five days from the day of receiving from the applicant all necessary documents.

#### **VI. ANNULMENT OF THE CERTIFICATE OF REGISTRATION**

18. The certificate of registration of the micro-credit organizations is annulled in the following cases:

request of the micro-credit organization to annul the certificate of registration;

termination of the micro-credit organization;

reorganization of the micro-credit organization;

breaches by the micro-credit organization of the requirements and terms envisaged by the current legislation, specifically:

insolvency of the micro-credit organization, i.e. incapacity to discharge the obligations before depositors and other creditors;

regular distortion of the return;

establishing inauthentic information on the basis of which registration was made.

The certificate of registration may be annulled by the Court ruling.

## VII. MAINTAINING THE REGISTER OF MICRO-CREDIT ORGANIZATIONS

19. The Central Bank maintains the register of micro-credit organizations, in which the following should be indicated:

the name of the micro-credit organization and its location (postal address), main information about the organization (full name of the head and the chief accountant, telephone number, bank account and other.);

the date of registration;

the reason and date of annulling the certificate validity;

the identification number of the tax payer;

other information.

Appendix

to the Statute on the procedure of issuance of the certificate of registration for  
the activity of micro-organizations without the right of attracting deposits from the  
population and non-commercial micro-credit organizations

**CERTIFICATE № \_\_\_\_\_**

of registration of micro-credit organizations without the right to accept deposits from the  
population and non-profit micro-credit organizations

Tashkent

« \_\_ » \_\_\_\_\_ 20 \_\_\_\_

Upon the decision of the Central Bank of the Republic of Uzbekistan of « \_\_ » \_\_\_\_\_ 20 \_\_\_\_  
The \_\_\_\_\_ micro-credit  
organization \_\_\_\_\_

\_\_\_\_\_ full name with indication of the type of the micro-credit organization (commercial, non-commercial)

\_\_\_\_\_ (postal address and other data)

is entitled to exercise the micro-financing activity in accordance with the legislation of the Republic of Uzbekistan.

The Micro-credit organization is included in the register of micro-credit organizations  
« \_\_ » \_\_\_\_\_ 20 \_\_\_\_ under #: \_\_\_\_\_

Deputy Chairman of the Central Bank  
of the Republic of Uzbekistan

\_\_\_\_\_ full name (seal)

\_\_\_\_\_ (signature)

Serial number AA № 000000

**Law of the Republic of Uzbekistan**

**ON MICRO-CREDIT AND MICRO-CREDIT ORGANIZATIONS**

Adopted by the Legislative Chamber \_\_\_\_\_

Approved by the Senate \_\_\_\_\_

**Section 1. GENERAL PROVISIONS**

**Article 1. Objective of the Law**

The objective of this Law shall be creation of a legal and organizational framework for the practice of micro-crediting in Uzbekistan in order to expand the access of small businesses and private entrepreneurs to financial services and in order to enhance the role of microfinancing in addressing prioritized social issues.

**Article 2. Legislation on Micro-credit and Micro-credit Organizations**

Legislation on micro-credit and micro-credit organizations shall be based on the Constitution of the Republic of Uzbekistan, this Law, and other statutory acts recognized by the Republic of Uzbekistan.

Should the provisions of an international treaty of the Republic of Uzbekistan differ from those established in the legislation of the Republic of Uzbekistan on micro-credit and micro-credit organizations, then the provisions of the international treaty shall be applied.

This Law shall not cover affairs related to the issuance of loans and micro-loans by commercial banks and other financial institutions.

The Law of the Republic of Uzbekistan “On Banks and Banking” and regulatory acts of the Central Bank adopted in compliance there under shall not be applied to micro-credit organizations except in those cases directly stipulated in this Law.

**Article 3. Basic Definitions**

The following basic definitions shall be used in this Law:

**borrower** – individual or legal entity – a subject of small, micro- and individual business in conformity with legislation;

**creditor** – micro-credit organization that issued micro-credit and/or micro-leasing to the borrower;

**micro-credit/micro-loan** (hereinafter -micro-credit) – non-cash and/or cash funds up to the maximum allowed amount, provided by creditors to the borrower in national currency on condition of finance charges and timely repayment;

**maximum amount of micro-credit** – credit of micro-credit organization up to the equivalent of three thousand U.S. dollars per borrower;

**maximum amount of micro-leasing** – loan of micro-credit organization up to the equivalent of ten thousand U.S. dollars per lessee;

**deposit** – funds deposited to a micro-credit organizations under the terms of full repayment with or without interest, which may be withdrawn by individuals or their legal representatives at the first request or the expiration of the agreed-upon period;

**micro-credit organization** – legal entity providing micro-credits, micro-leasing, and other financial services to small businesses, private entrepreneurs, and low income population groups.

#### **Article 4. Relations of Micro-credit Organizations with the Government and the Central Bank**

Micro-credit organizations shall be independent in setting up and conducting their operations within the competence granted under this Law, regulatory acts of the Central Bank adopted there under, and other laws of the Republic of Uzbekistan.

Micro-credit organizations shall not be responsible for liabilities of the Republic of Uzbekistan and the Republic of Uzbekistan shall not be responsible for liabilities of micro-credit organizations unless parties voluntarily undertake respective liabilities.

Micro-credit organizations shall not be responsible for liabilities of the Central Bank, and the Central Bank shall not be held responsible for liabilities of micro-credit organizations.

#### **Article 5. Title of Micro-credit Organization**

Micro-credit organizations shall be entitled to use only the title (or abbreviation) indicated in its Charter.

The title of the micro-credit organization must include the word combination “micro-credit organization” and must not be similar to titles of other micro-credit organizations. A legal entity not undertaking micro-credit activities and not meeting the requirements of this Law shall not be entitled to use the word combination “micro-credit organization”.

Micro-credit organizations shall not include the following words in any language in its title: “national”, “state”, “Republic of Uzbekistan”, “bank” or any other word in any language that may mislead the public.

Micro-credit organizations shall be obliged to notify the Central Bank in advance about changes in its title or location. After making the appropriate changes, micro-credit organizations shall be obliged to publish an appropriate notice in the media within three days.

Violations of this requirement shall be prosecuted according to the procedure stipulated in the legislation.

## **SECTION 2. ESTABLISHMENT AND OPERATIONS OF MICRO-CREDIT ORGANIZATIONS**

#### **Article 6. Forms of Micro-credit Organizations**

Micro-credit organization in the territory of the Republic of Uzbekistan may be set up in the following forms:

- Micro-credit organizations entitled to accept individual deposits;
- Micro-credit organization not entitled to accept deposits;
- Non-profit micro-credit organization.

#### **Article 7. Setting up Micro-credit Organizations**

Micro-credit organizations shall be set up by legal entities and/or individuals including foreign entities, other than government bodies, political parties, trade unions and religious organizations.

Micro-credit organizations shall be registered by the authorities in conformity with the legislation regulating the procedure for state registration of legal entities.

Micro-credit organizations entitled to accept individual deposits shall be granted the right to launch operations after being issued the appropriate license from the Central Bank.

Micro-credit organizations not entitled to accept deposits and non-profit microfinance organization shall be granted the right to launch operations after being issued the appropriate registration certificate from the Central Bank.

Micro-credit organizations may be commercial or non-profit institutions.

Commercial micro-credit organizations may be established in the form of a joint-stock company or a limited liability company.

Non-profit micro-credit organizations may be established in the form of a public association, public foundation, institution, and other forms stipulated in the Law on “Non-government Non-profit Organizations”.

Micro-credit organizations shall not be entitled to engage in manufacturing, trade, and dealership activities.

### **Article 8. Charter of Micro-credit Organization**

Micro-credit organizations shall operate in conformity with their Charters.

In addition to the information required by legislation for respective organizational and legal forms of legal entities, the Charter of micro-credit organization shall contain the following data:

- Micro-crediting operations;
- Structure, rights, and responsibilities of the management bodies responsible for issuing micro-credits;
- Sources to generate funds to be issued as micro-credits;
- Procedures for an external audit of micro-credit organization.

### **Article 9. Chartered Capital of Micro-credit Organization**

Chartered capital of micro-credit organizations shall consist of fully paid-up capital contributed by the founders. Monetary portions may be made up of national currency and/or foreign currency.

Chartered capital of micro-credit organizations shall be formed of cash and other non-cash assets not exceeding twenty percent of the amount of the organization’s chartered capital. In increasing chartered capital, the non-cash share of the amount of the increase shall not exceed the percentage ratio stipulated in the Central Bank’s regulatory acts.

The use of loan funds, funds under collateral, and other liabilities to form chartered capital of micro-credit organizations shall not be permitted.

The minimum chartered capital of micro-credit organizations must be formed only from cash prior to the date of application for license or registration certificate.

The minimum amount of chartered capital of micro-credit organizations entitled to accept individual deposits shall be determined by the Central Bank.

The minimum amount of chartered capital of micro-credit organizations not entitled to accept deposits and non-profit micro-credit organizations shall be determined in conformity with legislation of the Republic of Uzbekistan, depending on the form of ownership.

### **Article 10. Sources of Funding to Issue Micro-credits**

Micro-credit organizations shall issue micro-credits to individuals and legal entities based on the following sources:

- Individual deposits held (only for micro-credit organizations entitled to accept



- individual deposits);
- Equity of micro-credit organization;
- Funds provided by local and foreign investors directly for the purpose of issuing micro-credits based on investment contracts;
- Bank- and non-budget fund loans;
- Revenues generated in micro-crediting operations;
- Grants and loans of international financial institutions, non-state non-profit organizations, including foreign organizations;
- Other sources not prohibited by legislation.

Micro-credits shall be issued up to the amount of funds in the accounts of the micro-credit organization.

### **Article 11. Operations of Micro-credit Organization**

Micro-credit organizations can conduct the following auxiliary operations not exceeding maximum amount of micro-credit and other services:

Purchase and sale of liabilities (factoring);

Leasing (financial lease), where micro-credit organizations shall act as the Lessor up to the maximum size of micro-lease per Lessee;

Provide consulting and information services to its clients related to issuance of micro-credits.

Micro-credit organizations can issue micro-credit to several persons based on their joint responsibility up to the maximum amount of micro-credit.

Only micro-credit organizations entitled to accept individual deposits shall be permitted to accept individual deposits.

### **Article 12. Interest policy of micro-credit organizations**

Interest rates on micro-credits and commissions for operations and services shall be set by micro-credit organizations.

Micro-credit organizations shall not be permitted to unilaterally change the term of micro-credit agreements and interest rates on micro-credits issued except for the cases when it is envisioned by the loan agreement and does not create adverse consequences for the borrower.

The Central Bank shall not be authorized to regulate interest rates of micro-credit organizations.

The Central Bank shall be entitled to demand standardized information about interest rates and other commissions to enable existing and prospective clients to compare the costs of borrowed funds.

### **Article 13. Associations of Micro-credit Organizations**

Micro-credit organizations shall be entitled to set up alliances in the form of associations or unions to uphold and represent the common interests of their members, coordinate their activities, and meet informational and professional needs.

Micro-credit organizations shall not be permitted to use associations to set interest rates or commissions.

Disclosure limitations for confidential information of associations established in conformity with this Article shall be determined in the legislation of the Republic of Uzbekistan.

#### **Article 14. Subsidiaries of micro-credit organizations**

A subsidiary of micro-credit organization shall be a detached department of a micro-credit organization without legal entity status.

A subsidiary shall have a permanent location and operate on behalf of and based on the statute approved by its founding micro-credit organization.

A subsidiary's operations shall be regarded as the operations of its founding micro-credit organization. Subsidiaries must be mentioned in the charters of micro-credit organizations, which bear full liability for the operations of its subsidiaries.

A subsidiary shall have the same title as the micro-credit organization with the addition of the word "subsidiary" and an indication of its location.

A subsidiary shall not be subject to any specific requirements for chartered capital, and likewise, micro-credit organizations shall not face any requirements of additional capital after opening of a subsidiary.

After notifying the Central Bank of their titles and locations, micro-credit organizations shall be entitled to open subsidiaries throughout the territory of the Republic of Uzbekistan.

#### **Article 15. The reorganization and Closure of micro-credit organizations**

The reorganization and closure of micro-credit organizations shall be performed according to the procedures stipulated in the legislation of the Republic of Uzbekistan.

Voluntary re-organization and closure of micro-credit organizations entitled to accept individual deposits shall be performed according to the procedures stipulated in the legislation of the Republic of Uzbekistan.

#### **Article 16. Keeping the registry of micro-credit organizations**

The Central Bank shall keep the registry of all micro-credit organizations.

Information about micro-credit organizations contained in the Central Bank register shall be published annually in the official publication of the Central Bank or in national publications. Changes and additions to the register (including information about annulled and withdrawn licenses and registration certificates) shall be published within one month of their introduction into or exclusion from the register.

#### **Article 17. Storage of Records**

The storage of records related to operations of micro-credit organizations shall be conducted in conformity with legislation.

### **SECTION 3. LICENSING MICRO-CREDIT ORGANIZATIONS ENTITLED TO ACCEPT INDIVIDUAL DEPOSITS**

#### **Article 18. Procedures to Award Central Bank License**

A Central Bank-developed license to perform operations of micro-credit organization entitled to accept individual deposits shall be the document which certifies the right to operate as micro-credit organization.

The license shall indicate the list of operations performed by a micro-credit organizations entitled to accept individual deposits.

Applications with all documents required to get a license shall be reviewed by the Central Bank within 30 days after their receipt.

Notice of a license granted shall be sent to the applicant in writing within 3 days of the appropriate decision being made.

After issuing the license, the Central Bank shall provide appropriate legal documentation to those micro-credit organizations entitled to accept individual deposits.

A state fee shall be levied to issue a license for micro-credit organizations entitled to accept individual deposits.

The state fee shall be levied in the amount of five minimum monthly wages set by legislation of the Republic of Uzbekistan.

The state fee shall be transferred to the national budget.

Should the applicant dismiss the application to issue a license during the period of review of his or her documents, the state fee shall not be reimbursed.

### **Article 19. Documents Required to Award License**

In order to get a license, the following must be submitted to the Central Bank:

- application in Central Bank-approved form to grant a license to conduct micro-credit operations with the right to accept individual deposits;
- Minutes of the General Meeting of Founders;
- Charter or Statute of the micro-credit organization (original or notarized copy);
- Business-plan of the micro-credit organization;
- Notarized copy of state registration certificate;
- List of founders indicating:
  - For individuals:
    - Family name, first name, patronymic, passport data, place of residence, mailing address, telephone numbers, profession, workplace, and positions;
  - For legal entities:
    - full title, mailing address, telephone numbers, banking information, and documents proving their financial status;
    - list of managers of executive bodies of micro-credit organization;
    - bank records certifying the availability of minimal chartered capital of micro-credit organizations entitled to accept individual deposits.

This list of documents is comprehensive. Requests to submit records not mentioned in this Article of the Law shall not be permitted.

Documents shall be delivered to the Central Bank or its local office by the applicant himself.

The applicant shall be responsible by law for submitting false or inaccurate information.

### **Article 20. Grounds to Deny License**

The Central Bank shall be entitled to refuse to issue licenses to micro-credit organizations entitled to accept individual deposits on the following grounds:

- Failure to provide full list of documents required to get a license;
- Legal discrepancies between the charter and other documents submitted;
- False or inaccurate data in the records and any inadequacy of the business-plan;
- Unsatisfactory financial status of one or several founders – legal entities;
- Failure to raise required minimum amount chartered capital at the moment of application to get a license;
- Failure of candidates for CEO and Chief Accountant to meet professional qualification requirements;

Written notice of refusal to issue license shall be sent within 3 days to the applicant indicating the grounds for refusal.

The decision to deny license may be appealed in court.

The Central Bank shall review documentation for a second time within 10 days of receiving all required documentation.

### **Article 21. Procedure to Suspend License**

The Central Bank may suspend the license of micro-credit organization entitled to accept individual deposits in the following cases:

Detection of any violation of the requirements, terms, and conditions of this Law and other regulatory acts of the Central Bank as well as licensing requirements and conditions;

Failure to comply with Central Bank's instructions mandating any remedies for violations cited.

Decisions with justification of the decisions to suspend the licenses shall be communicated in writing by the Central Bank to the micro-credit organization entitled to accept individual deposits no later than three days after it was made.

Decisions of the Central Bank to suspend licenses may be appealed in court.

The Central Bank shall be required to specify a time period given to the licensee to remedy the circumstances that led to the suspension of the license. This period shall not exceed six months.

In case the circumstances that led to the suspension of the license have been removed, the Central Bank shall make a decision to reinstate the license within ten days after receiving appropriate documents.

### **Article 22. Procedure for Termination of License**

Licenses shall be terminated in the following circumstances:

- Application of a micro-credit organization entitled to accept individual deposits to terminate the license;
- Closure of a micro-credit organization entitled to accept individual deposits from the moment of closure or termination;
- Re-organization of a micro-credit organization entitled to accept individual deposits from the moment of its re-organization, unless it is transformed.
- Any violation by micro-credit organization entitled to accept individual deposits of the requirements, terms, and condition under this Law and other regulatory acts, namely:
  - Insolvency of micro-credit organization entitled to accept individual deposits, i.e. the inability to meet its commitments before depositors or creditors;
  - Systematic distortion of reporting data;
  - The identification of false data used as grounds to issue the license;
  - Delay in transactions over one year after the license has been issued;

- Failure of a micro-credit organization entitled to accept individual deposits to remedy the circumstances which led to suspension of its license by the deadline set by the Central Bank.
- License may be terminated by court ruling.
- License shall be terminated from the date of the decision to close down the activities of the micro-credit organization entitled to accept individual deposits.

### **Article 23. Annulment of License**

Licenses shall be annulled by the Central Bank in the following cases:

Application of the micro-credit organization entitled to accept individual deposits to annul its license;

Establishing the fact that forged documents were used in license application.

Licenses may also be annulled by court ruling.

### **Article 24. Validity of Central Bank license**

Licenses for micro-credit organizations entitled to accept individual deposits shall be issued for an unlimited period of time.

The transfer of license to another legal entity shall not be permitted.

### **Article 25. Qualification Requirements for Managerial Staff of Micro-credit Organization entitled to accept Individual Deposits**

The chief executive officer, his deputies, the chief accountant and his deputies, as well as the managers and chief accountants of subsidiaries of micro-credit organizations shall be the managerial staff of micro-credit organizations.

Qualification requirements for the managerial staff of micro-credit organization shall be determined by the Central Bank and must be relevant to educational background, general work experience, and any histories of conviction for deliberate crime.

In case of any staff changes, micro-credit organizations must inform the management of Central Bank of all changes within two days of the decision being made.

### **Article 26. Conflict of Interests**

The management staff of micro-credit organizations cannot:

- concurrently be a member of the Board of Directors, or a management staff member or employee of any other micro-credit organization operating in Uzbekistan;
- concurrently be an official or employee of any government body including local authorities;
- participate in discussions and votes on issues of his personal interest.

### **Article 27. Records and Reporting of Micro-credit Organizations Entitled to Accept Individual Deposits**

Accounting procedures and guidelines, lists, forms, and deadlines of financial reporting as well as liability for violation shall be set forth by the Central Bank.

Accounting principles and plans of accounts shall be established by the Central Bank in conformity with international accounting standards.

#### **SECTION 4. REGULATION AND OVERSIGHT OF OPERATIONS OF MICRO-CREDIT ORGANIZATIONS ENTITLED TO ACCEPT INDIVIDUAL DEPOSITS**

##### **Article 28. Authority of the Central Bank as a Regulatory and Oversight Body**

In order to ensure the financial sustainability of micro-credit organizations entitled to accept individual deposits and in order to protect the interests of depositors, within its competence the Central Bank shall regulate and oversee the operations of micro-credit organizations entitled to accept individual deposits by establishing regulatory and other requirements introduced in compliance with this Law.

The Central Bank shall establish mandatory guidelines for financial transactions, accounting, and reporting for micro-credit organizations entitled to accept individual deposits.

In the procedure established by legislation, the Central Bank shall:

- verify reporting and other records of micro-credit organizations entitled to accept individual deposits;
- audit the activities of micro-credit organizations entitled to accept individual deposits;
- issue mandatory instructions to micro-credit organizations entitled to accept individual deposits in order to remedy violations identified in their activities;
- establish qualification requirements for managers of micro-credit organizations entitled to accept individual deposits;
- Oversee the activities of micro-credit organizations entitled to accept individual deposits in order to ensure their compliance with economic regulations;
- Suspend, terminate, and annul the licenses of micro-credit organizations entitled to accept individual deposits.

##### **Article 29. Mandatory Economic Requirements of the Central Bank**

In order to secure the financial viability of licensed micro-credit organizations entitled to accept individual deposits and in order to prevent losses of small depositors, the Central Bank shall develop financial implementation requirements.

Micro-credit organizations entitled to accept individual deposits shall meet the following financial requirements which will be established by the Central Bank:

- Minimum amount of chartered capital;
- Maximum amount of non-cash share of chartered capital not exceeding 20 percent;
- Liquidity requirement;
- Amount of reserves to cover losses;
- Amounts of currency, interest rate, and other risks;
- Requirements for transactions involving groups of mutually dependant borrowers;
- Maximum ratio of deposits accepted to total capital.

##### **Article 30. Inspecting the operations of micro-credit organizations entitled to accept individual deposits**

The Central Bank shall conduct inspections of operations of micro-credit organizations entitled to accept individual deposits in the form of on the spot and desk audits. Inspection procedures shall be established by the Central Bank.

### **Article 31. Security Guarantees for Individual Deposits**

Micro-credit organizations entitled to accept individual deposits which hold a Central Bank license must participate in the system of guaranteed insurance of individual deposits by making regularly scheduled contributions in conformity with the Law of the Republic of Uzbekistan on Security Guarantees for Bank Deposits of Individuals.

## **SECTION 5. RECEIPT OF REGISTRATION CERTIFICATE FOR MICRO-CREDIT ORGANIZATION NOT ENTITLED TO ACCEPT DEPOSITS AND NON-PROFIT MICRO-CREDIT ORGANIZATIONS**

### **Article 32. Procedure for Receiving a Registration Certificate for a Micro-credit Organization**

The registration certificate in Central Bank-developed form shall be a document which certifies the right of micro-credit organization not entitled to accept deposits and non-profit micro-credit organizations.

Applications for registration certificates along with all required documentation shall be reviewed by the Central Bank within 15 calendar days of their receipt.

The Central Bank shall issue legal documentation in three copies:

- One copy shall be issued to the CEO of the micro-credit organization after he/she signs it;
- One copy shall be kept at the Central Bank;
- One copy shall be sent to the Main Territorial Department of the Central Bank at the location of the micro-credit organization.

### **Article 33. Documentation Required for Registration Certificate**

In order to obtain a registration certificate, the following must be submitted to the Central Bank:

- Application in Central Bank-approved form for a registration certificate of a micro-credit organization;
- Minutes of the General Meeting of the Founders about the establishment of a micro-credit organization (in case of more than one founder);
- Notarized copy of the certificate of state registration of the micro-credit organization;
- Charter or statute of the micro-credit organization (original or notarized copy);
- Business-plan of the micro-credit organization;
- List of founders indicating
  - For individuals:
    - Family name, first name, patronymic, passport data, mailing address, telephone numbers;
  - For legal entities:
    - Full title, mailing address, telephone numbers, bank account information;
    - Bank receipt showing payment of the registration fee;

- List of managerial staff of executive body of the micro-credit organization;
- Bank document certifying the generation of the micro-credit organization's minimum chartered capital.

This list of documents is exhaustive. Requests to submit documentation not stipulated in this Law shall not be permitted.

Documentation shall be personally delivered to the Central Bank or to its territorial department by the applicant.

For providing false or inaccurate information, the applicant shall be responsible in accordance with legislation.

#### **Article 34. Grounds for Refusal to Issue Registration Certificate of Micro-credit Organization**

The Central Bank is entitled to refuse to issue registration certificate to micro-credit organizations for the following reasons:

- The required documentation submitted for the registration certificate was not properly filed;
- The existence of false or inaccurate data in the documentation submitted;
- The non-compliance of founding documents with the requirements stipulated in this Law;
- The failure to produce minimum required amount of chartered capital of micro-credit organization.

Notice of refusal to issue registration certificate shall be sent to the applicant in writing within 3 days indicating the grounds for refusal.

Decisions to deny registration certificate may be appealed in court.

A second review of documentation shall be done by the Central Bank within 10 days of receiving all required documentation.

#### **Article 35. Registration Certificate Fee**

Micro-credit organizations shall be levied a registration certificate fee in the amount of one monthly minimum wage established by law on the date of application.

The amount of the registration certificate fee shall be deposited to a special account of the Central Bank.

Should the applicant abandon his application while it is being reviewed, the amount of fee paid shall not be reimbursed.

If micro-credit organization is denied registration, the registration fee paid shall be reimbursed by the Central Bank within 3 days.

#### **Article 36. Validity of Registration Certificate**

Registration certificates issued by the Central Bank in compliance with this Law shall be valid throughout the Republic of Uzbekistan and for an unlimited time period. In case of a merger between two or more micro-credit organizations, their registration certificates shall be annulled, while the newly created micro-credit organization must apply for a registration certificate from the Central Bank in compliance with this Law.

#### **Article 37. Annulment of Registration Certificate**



Registration certificates of micro-credit organizations shall be annulled in the following circumstances:

- Application of a micro-credit organization to annul its registration certificate;
- The shutting down of a micro-credit organization;
- The re-organization of a micro-credit organization;
- Any violation of the requirements and conditions stipulated by current legislation by micro-credit organization namely:
  - Insolvency of micro-credit organization, i.e. the inability to meet its liabilities before depositors or other creditors;
  - Systematic inaccuracies in reported data;
  - The identification of false information having been used to issue a registration certificate.

Registration certificates may be annulled by court ruling.

### **Article 38. Record-keeping and Reporting**

Micro-credit organizations not entitled to accept deposits and non-profit micro-credit organizations shall file annual reports to the Central Bank including all reporting forms along with a report of the findings of an external audit.

Procedures and rules of accounting and liabilities for violating them shall be established by the Central Bank.

## **SECTION 6. ISSUING MICRO-CREDITS**

### **Article 39. Basic Terms of Micro-crediting**

Micro-credits shall be issued in national currency in non-cash funds and/or in cash.

General procedures and terms of micro-crediting shall be established by internal rules of micro-crediting organizations, and approved by the authorized management bodies of micro-credit organizations.

Rules of micro-crediting must be universally accessible and contain basic requirements to apply for micro-credit including micro-credit amount, interest rate, repayment schedule, exact amount of payments including interest to be paid by the borrower.

Relations of the creditor and borrower shall be regulated by the contract to issue a micro-credit. Interest rates for using micro-credit shall be set by agreement of the parties in conformity with micro-credit application policies.

### **Article 40. Procedures for the Review of a Micro-credit Application**

In order to get a micro-credit, applicants shall file a written loan application in accordance with micro-credit application policies.

Loan applications shall be signed by the applicant indicating the date of application.

In reviewing loan applications creditors shall analyze the following:

- Sustainable income and/or feasibility of planned activities;
- Consistency of information, so that all data provided in the loan application are consistent with each other and with other sources of information;
- Probability of micro-credit repayment.

Creditors shall make a decision to issue or refuse micro-credit with the grounds for the latter no more than fifteen business days after receipt of a loan application.

In the case of justified denial to issue a micro-credit, the creditor shall inform the applicant of the reasons for denial and make the appropriate minutes of the decision of Loan Committee at the first request.

In the case of an applicant's subsequent application after remedying the indicated flaws, the creditor shall review loan application in the next scheduled meeting of Loan Commission, and the creditor must inform the applicant of its decision, and provide the appropriate minutes.

#### **Article 41. Micro-credit Agreement**

The micro-credit agreement (hereinafter - Agreement) shall be made in writing.

The Agreement must include the following:

Family name, first name, patronymic, passport data (or document substituting passport) or full tile and other information of the borrower;

Full title and other data of the creditor;

Subject of the Agreement;

Total amount of micro-credit;

Procedure and method of issuing the micro-credit;

Interest rate;

Micro-credit repayment procedure and schedule;

Rights and responsibilities of the parties;

Liabilities of the parties in case of a failure to meet or failure to duly meet the terms and conditions of the Agreement;

Conditions for changing and canceling the agreement;

Other terms in conformity with legislation.

The following terms can be included in the agreement with the consent of both parties:

Guarantees of the borrower to honor his liabilities;

Force majeure circumstances;

Procedures to oversee the observance of the terms and conditions of the Agreement.

#### **Article 42. Modification and Termination of Agreement**

The Agreement can be modified and terminated with the consent of both parties unless otherwise stated in this Law, other legislative acts or the Agreement.

The Borrower shall be entitled to reject unused micro-credit within two weeks of signing the Agreement by notifying the creditor in writing. These terms shall be set by the micro-crediting policies and stipulated in the agreement.

The Creditor shall be entitled to unilaterally terminate the agreement if the borrower has not used the micro-credit within one month after making of Agreement by providing written notice to the borrower.

The Date of submitting the letter to the creditor/borrower or postmark date shall be considered the date of notification.

#### **Article 43. Advanced Repayment**

The borrower shall be entitled to repay the principal and interest of micro-credit ahead of schedule. In this case interest payments shall be made only for the period of the micro-credit's actual use.

The deadline for advanced repayment of micro-credit shall be established by internal policies of the micro-credit organization and reflected in the terms and conditions of the contract.

#### **Article 44. Borrower's Guarantees of Repayment**

The repayment of a borrower's liabilities may be guaranteed by warranty, joint responsibility, collateral, surety, insurance policy, and other methods stipulated in the agreement.

Revenues and warranty provided by the borrower to guarantee to honor liabilities related to micro-credit must be sufficient to repay the micro-credit principal and accrued interest.

Micro-crediting policies may include procedures to provide micro-credit without guarantee (blank loan).

#### **Article 45. Rights and Responsibilities of the Creditor**

Creditor shall be entitled to:

Grant or deny micro-credit to the applicant on reasonable grounds;

Provide micro-credits with or without collateral;

Request information required to issue micro-credit and meet contractual obligations;

In case of a Borrower's failure to repay the micro-credit in a timely manner, demand advance repayment in the amount of the micro-credit, interest accrued and fines.

The Creditor shall be responsible for:

- Making micro-crediting policies available in a place accessible for review;
- Providing accurate and comprehensive data about the terms of micro-credit;
- Informing the applicant of all costs associated with the issuance of micro-credit prior to signing the agreement;
- Informing the borrower of his rights and responsibilities related to the receipt of micro-credit;
- Issuing micro-credit according to the timeframe and procedure laid down in the agreement.

The Creditor may have other rights and responsibilities as stipulated by legislation or the Agreement.

#### **Article 46. Rights and Responsibilities of the Borrower**

Borrower shall be entitled to:

- Receive reliable and accurate information about the terms of micro-credit;
- Review micro-crediting policies of the creditor;
- Use micro-credit funds in business activities;
- Use micro-credit without hindrance for the purposes established in the Agreement;
- Demand immediate fulfillment of the terms of the agreement by the deadlines and terms of the agreement.

The Borrower shall be responsible for:

- Providing records and data requested by the creditor in conformity with this Law;
- Using the micro-credit received for due purpose outlined in the Agreement;
- Repaying the principal of micro-credit received and accrued interest within the timeframe and procedure set in the agreement.

The Borrower may have other rights and responsibilities established by legislation or the Agreement.

## **SECTION 7. FINAL PROVISIONS**

### **Article 47. Raising Reserve Funds**

The establishment of a reserve fund shall be envisioned in order to compensate credit losses arising in the operations of micro-credit organizations.

The amount and procedure for raising reserve funds for micro-credit organizations entitled to accept individual deposits shall be established by appropriate regulatory acts of the Central Bank.

The amount of the reserve fund of micro-credit organizations not entitled to accept deposits and non-profit micro-credit organizations shall be established by the charters of these organizations.

Micro-credit organizations shall be entitled to set up other funds designed to ensure their financial sustainability provided they are in compliance with the legislation of the Republic of Uzbekistan.

Fees to raise reserves to cover possible credit losses shall be viewed as expenditures of micro-credit organizations deducted from the taxable base in conformity with the legislation of the Republic of Uzbekistan.

### **Article 48. Confidentiality of Micro-crediting**

The confidentiality of micro-crediting covers Borrower data protected by the Creditor *inter alia* regarding the amount of micro-credits, transactions, and other terms of the micro-credit agreement received by the Creditor in order to provide services to the Borrower.

The Creditor shall guarantee the protection of confidential micro-crediting data. The Creditor shall be entitled to inform the court of confidential Borrower micro-crediting data in the circumstances and to the limits necessary to secure its own rights and legitimate interests, should dispute arise between the Creditor and Borrower.

Confidential micro-crediting data shall be disclosed in compliance with the Law on “Confidential Banking Information”.

### **Article 49. Audit of Micro-credit Organization**

Micro-credit organizations’ operations shall be audited annually by external auditors possessing the appropriate license to conduct this form of audit.

Micro-credit organizations shall have the right to choose an audit company.

Micro-credit organizations shall be required to submit to the Central Bank one original or a copy of an external auditor report without changes (management report and financial reports) within ten days after receiving the report from the external auditors.

The annual external audit includes:

- Identification of the availability of the appropriate amount of chartered capital and the financial sustainability of the micro-credit organization;
- Verification of timeliness, integrity, and accuracy of transactions in recordkeeping and reporting;
- Verification of the compliance of transactions with general regulations as well as conformity of the procedure for transactions with the internal policies of the micro-credit organization.

External auditor shall provide audit findings and his opinion in the report shall be submitted to the micro-credit organization.

#### **Article 50. Resolution of Disputes**

Disputes related to issuance of micro-credits shall be resolved according to the procedures established in legislation.

#### **Article 51. Liability for Violation of Legislation on Micro-credit and Micro-credit Organizations**

Persons responsible for violation the legislation on micro-crediting and micro-credit organizations shall be prosecuted according to established procedures.

#### **Article 52. Entry of the Law Into Force**

This Law shall enter into force on the day of its official publication.

All active organizations involved in microfinancing activities in the territory of the Republic of Uzbekistan (except commercial banks and other financial organizations) shall be obliged to bring their activities into compliance with the requirements of this Law within 6 months of the date of its adoption.

**President  
of the Republic of Uzbekistan**