

# **ANNEXES**

**to the Medium Term Microfinance Development Strategy  
in the Kyrgyz Republic for 2006-2010  
approved by the Resolution of the Government of the Kyrgyz Republic  
and  
the National Bank of the Kyrgyz Republic**

**#637/37/7 of December 30, 2005**

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## **INTRODUCTION**

This document contains the annexes to the Strategy with general and detailed information consisting of the following sections:

- 1) Action plan for implementing the Strategy;
- 2) Analysis of the microfinance sector in Kyrgyzstan;
- 3) Analysis of legal and regulatory microfinance environment;
- 4) Overview of the technical assistance;
- 5) Meso structure (infrastructure of the financial system).

This document is based on the research that was conducted by the group of specialists from the Dutch consulting company FACET BV in close collaboration with the employees of the National Bank of the Kyrgyz Republic.

The analysis contained in this document formed the basis for SWOT analysis of the microfinance sector of the Kyrgyz Republic and the follow-up formulation of the Strategy.

**ANNEX 1. ACTION PLAN FOR IMPLEMENTING THE MEDIUM TERM MICROFINANCE DEVELOPMENT STRATEGY IN THE KYRGYZ REPUBLIC**

#	Activity	Responsible Organization	Implementation Period	Form of Implementation
<b>1. Activities on improving legal and regulatory microfinance environment</b>				
<b>Activities on improving the legal framework regulating operations of microfinance organizations</b>				
1.1	Establish a working group to prepare a draft law of the Kyrgyz Republic “On the introduction of amendments and addenda to the Law of the Kyrgyz Republic “On Microfinance Organizations in the Kyrgyz Republic”	National Bank of the Kyrgyz Republic, Ministry of Justice of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination)	2006	Approval of the list of the working group members and the work plan of the working group
1.2	Conduct a thorough analysis of the Law “On Microfinance Organizations in the Kyrgyz Republic” with a view to find available inconsistencies with other legislative acts of the Kyrgyz Republic, as well as other deficiencies that hinder the improvement in the efficiency of activities of microfinance organizations. Prepare draft amendments and addenda to the Law of the Kyrgyz Republic “On Microfinance Organizations in the	National Bank of the Kyrgyz Republic, Ministry of Justice of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination)	2008	Promotion of the draft law on the introduction of amendments and addenda to the Law of the Kyrgyz Republic “On Microfinance Organizations in the Kyrgyz Republic” in Jogorku Kenesh of the Kyrgyz Republic according to the established procedure.

	Kyrgyz Republic”			
1.3	Consider the possibility to revise Attachment 1 of the Interim Regulation “On the Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic” currently in effect (approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #42/1 of October 11, 2002, registered with the Ministry of Justice of the Kyrgyz Republic #143-02 of November 14, 2002) with regard to introducing addenda to the list of international organizations qualified to serve as the founders of microfinance companies without limiting their share interest.	National Bank of the Kyrgyz Republic	2006	Approval of draft amendments and addenda to the Interim Regulation ‘On the Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic’ (in case of an affirmative decision).
1.4	Consider the possibility to simplify the procedures relating to the registration of microfinance organizations, the procedure of reporting submission by microfinance organizations to public bodies.	Ministry of Justice of the Kyrgyz Republic, State Tax Inspection under the Government of the Kyrgyz Republic, Associations of microfinance organizations (in coordination)	2007	Introduction of amendments and addenda to relevant normative legal acts
<b>Activities on the improvement of the legal framework regulating activities of commercial banks</b>				

1.5	Consider the possibility to revise the existing Regulation “On Lending in Commercial Banks and Other Financial and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic” (approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #12/7 of April 27, 2005, registered with the Ministry of Justice of the Kyrgyz Republic #69-05 of June 3, 2005) in order to provide the opportunity of micro crediting to commercial banks and non-bank financial and credit institutions, provided that the adequate risk supervision system will be maintained.	National Bank of the Kyrgyz Republic	2006	Introduction of amendments and addenda to the Regulation “On Lending in Commercial Banks and Other Financial and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic”.
<b>Activities on the improvement of the legal framework regulating activities of credit unions</b>				
1.6	Conduct a thorough analysis of the Law of the Kyrgyz Republic “On Credit Unions” with a view to find available inconsistencies with other legislative acts of the Kyrgyz Republic, as well as other deficiencies that hinder the improvement in the efficiency of operations of credit unions.	National Bank of the Kyrgyz Republic, “Financial Company for Support and Development of Credit Unions in the Kyrgyz Republic” Limited Liability Company (in coordination), Associations of Credit Unions (in	2006	Preparation of the draft law “On the Introduction of Amendments and Addenda to the Law of the Kyrgyz Republic “On Credit Unions”.

		coordination).		
1.7	Revise the existing Regulation “On Licensing of Credit Unions” (approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #14/3 of May 4, 2005, registered with the Ministry of Justice of the Kyrgyz Republic #75-05 of June 10, 2005) to the extent of possible introduction of amendments and addenda with respect to minimum requirements of the National Bank of the Kyrgyz Republic for obtaining a license entitling to attract deposits.	National Bank of the Kyrgyz Republic	2006	Introduction of amendments and addenda to the Regulation “On Licensing of Credit Unions”
<b>Activities on the simplification of pledge registration and impressment procedures</b>				
1.8	For the purposes of reducing operating expenses of microfinance organizations, conduct an analysis of the legislation of the Kyrgyz Republic, regulating the relationships connected with the registration and impressment of the pledge with a view of available inconsistencies and other deficiencies that contribute to the increase of operating costs of microfinance institutions, and submit proposals for	Ministry of Justice of the Kyrgyz Republic, State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination),	2006	Preparation of proposals on introducing amendments and addenda to the legislation of the Kyrgyz Republic regulating the relationships connected with the registration and impressment of the pledge.



	their elimination.	Associations of Commercial Banks (in coordination), Associations of Credit Unions (in coordination).		
1.9	Prepare and ensure the promotion of the draft Law with the package amendments to the legislative acts of the Kyrgyz Republic, regulating the pledge relationships that shall also contain amendments aimed at simplifying the transfer mechanism of the pledged agricultural land and its foreclosure, in case of failure to fulfill obligations secured by the pledge.	Ministry of Justice of the Kyrgyz Republic, State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination), Associations of Commercial Banks (in coordination), Association of Credit Unions (in coordination).	2006	Preparation of the draft law on the introduction of amendments and addenda to certain legislative acts of the Kyrgyz Republic regulating the issues of pledge registration and impressment (Civil Code of the Kyrgyz Republic, Land Code of the Kyrgyz Republic, Laws of the Kyrgyz Republic “On Pledge”, “On Notariate”, “On Management of Agricultural Land” and so forth).
1.10	A) Consider the possibility to locate notary’s offices, offices of the State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic and Central Pledge Registration Office in one building.  B) Consider the possibility of opening representative offices of the State Registry in aiyl okmoty and entitle	Ministry of Justice of the Kyrgyz Republic, State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination), Associations of Credit	2006	Preparation of proposals for introducing amendments and addenda to relevant normative legal acts

	them to perform all functions on the registration and execution of the pledged property in order to reduce the costs of the rural population.	Unions (in coordination), Associations of Commercial Banks (in coordination).		
1.11	Consider issues related to the simplification of pledge registration procedures for repeat borrowers that use one and the same pledge	State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Ministry of Justice of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination), Associations of Commercial Banks (in coordination), Associations of Credit Unions (in coordination).	2006	Introduction of amendments to relevant normative legal acts
1.12	Consider the possibility to revise annual certification requirements for the immovable property used as the pledge in obtaining loans.	State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination), Associations of Commercial Banks (in coordination),	2006	Introduction of changes to the subordinate legislation of the State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic

		Associations of Credit Unions (in coordination).		
1.13	Consider the possibility of reducing amounts of fees and costs of services of authorized public bodies for microfinance organizations in registering the pledge.	Ministry of Justice of the Kyrgyz Republic, State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic	2006	Preparation of the draft Resolution of the Government of the Kyrgyz Republic aimed at minimizing (for microfinance organizations) amounts of fees and costs of services rendered by bodies qualified to register and impress the pledge.

1.14	Ensure access of microfinance organizations to information about the activity on the preparation and promotion of amendments to legislative acts, as well as the access to information on new changes made to the legislation aimed at improving pledge registration and impressment procedures in extrajudicial procedure.	Ministry of Justice of the Kyrgyz Republic, State Agency on Registration of Title to Real Property under the Government of the Kyrgyz Republic, Associations of Microfinance Organizations (in coordination), Associations of Commercial Banks (in coordination), Associations of Credit Unions (in coordination).	On-going	Issuance of various information products (brochures, manuals, bulletins, heralds) on the applicable legislation and on its changes. Creation of a special Internet site of the Association of Microfinance Organizations, Association of Credit Unions. Create the possibility for MFOs and CUs to access various data bases with legal information on applicable legislation, including pledge legislation.
<b>Activities on taxation improvement in financial and credit institutions</b>				
1.15	Consider the possibility of tax exemption for expenses on establishing ALL for microcredit agencies and microcredit companies that have the certificate of registration of the	A working group on the preparation of the draft revised version of the Tax Code of the Kyrgyz Republic,	2006	

	National Bank of the Kyrgyz Republic as in the case of financial and credit institutions that have the license of the National Bank of the Kyrgyz Republic.	Ministry of Economics and Finance of the Kyrgyz Republic		
1.16	Consider the possibility of streamlining the taxation of interest income from leasing transactions in order to facilitate the use of leasing by micro and small enterprises for acquisition of equipment.	A working group on the preparation of the draft revised version of the Tax Code of the Kyrgyz Republic, Ministry of Economics and Finance of the Kyrgyz Republic	2006	
1.17	Consider the possibility of providing benefits on withholding expenses for acquisition of fixed assets (computers, communication facilities), intangible assets, organizational costs due to the establishment of microfinance organizations to promote investments in information technologies, expand the resource base of microfinance organizations, especially, during the first years of operation	State Tax Inspection under the Government of the Kyrgyz Republic, A working group on the preparation of the draft revised version of the Tax Code of the Kyrgyz Republic, Ministry of Economics and Finance of the Kyrgyz Republic Associations of Microfinance Organizations (in coordination)	2006	

1.18	Consider the possibility to exempt income from services on the provision of credit resources by financial and credit institutions from the tax for fee-based services to the public.	State Tax Inspection under the Government of the Kyrgyz Republic, A working group on the preparation of the draft revised version of the Tax Code of the Kyrgyz Republic, Ministry of Economics and Finance of the Kyrgyz Republic Associations of Microfinance Organizations (in coordination)	2006	
<b>2. Activities on expansion of geographical scope and coverage of the poorest households with microfinance services</b>				
2.1	Facilitate the capacity building of active MCAs established on the basis of self-help groups and the expansion of microfinance services outreach to self-help groups in remote areas.	United Nations Development Program (in coordination)	On-going	Practical steps
<b>3. Activities on diversification of microfinance services and capacity building of providers of microfinance resources</b>				
3.1	Assist in: - the development of new products of microfinance organizations and credit unions, or in the modification of existing ones oriented at meeting the	Associations of Microfinance Organizations (in coordination), Associations of Credit Unions (in coordination)	Ongoing	Expand the range of financial services rendered by financial and credit institutions, improve clients' loyalty

	needs of clients (micro leasing, micro insurance, mortgage loans); - obtaining innovation grants for the development of new products by rural micro credit agencies and credit unions working with poor households.			
3.2	Development and introduction of pilot products and lending facilities for financing agriculture (for example, financing storages, commodity loans) with the involvement of other financial and credit institutions, cooperatives, suppliers of equipment and raw materials, trading companies	Close-end Joint Stock Company “Kyrgyz Agricultural Financial Corporation” (in coordination), Associations of microfinance organizations (in coordination) Associations of credit unions (in coordination)	On-going	Expand the types of loan products for rural commodity producers
3.3	Increase financial sustainability of microfinance organizations and credit unions by implementing the following activities: - ensure access of microfinance organizations and credit unions to adequate lending methodologies - improve risk management systems, loan portfolio management and monitoring systems of microfinance organizations and credit unions	Association of microfinance organizations (in coordination), Associations of credit unions (in coordination)	On-going	Increase the yield, the return on assets, gradually decrease operating costs by developing effective internal procedures

3.4	Encourage professional and business contacts between commercial banks and non-bank financial and credit institutions for the purposes of: - exchange of technologies - their strategic merger - obtaining loans by microfinance organizations from commercial banks (transparency of non-bank financial and credit institutions, external audit, achievement of particular level in development, creation of common information field, own web-sites)	Associations of microfinance organizations, Associations of credit unions (in coordination)	On-going	Conclude memoranda on cooperation between non-bank financial and credit institutions and wholesale organizations, the increase in volumes of funding non-bank financial and credit institutions by commercial banks, the increase in the number of own wholesale suppliers (commercial banks)
3.5	Encourage institutional capacity building of microfinance organizations and credit unions through an on-going training of staff by concluding contracts with training and consulting centers	Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)	On-going	Organization of trainings
<b>4. Activities on expanding the funding sources of microfinance service providers</b>				
4.1	Research the demand for financial services among small farmers and rural households by regions, including: the analysis of the demand for microfinance services, the survey of client's satisfaction with microfinance services, the impact of microfinance on	Association of microfinance organizations (in coordination), Associations of credit unions (in coordination)	2006  2007	Prepare a substantiation and obtain a grant for conducting a research  Conduct bid for the purposes of selecting an organization that will conduct this research



	poverty reduction.		2008	Publish the results of performed research and place them on relevant web-sites in order to provide required information to potential investors and international donors for their decision making on expanding their presence in rural areas.
4.2	Assist microfinance organizations and credit unions in obtaining international technical assistance for the development of new savings products  Provide detailed information to microfinance organizations and credit unions about international experience on savings mobilization among the poor	Associations of microfinance organizations (in coordination), Association of credit unions (in coordination)	On-going  On-going	Development of new savings products oriented at the poor  Conduct relevant seminars and so forth

4.3	<p>Assist in:</p> <ul style="list-style-type: none"> <li>- publishing on Mix Market<sup>1</sup> electronic page the reporting of microfinance organizations and credit unions with limited access to Internet.</li> <li>- organizing special trainings on financial transparency indicators and standards</li> </ul>	<p>Associations of microfinance organizations (in coordination), Association of credit unions (in coordination)</p>	On-going	<p>Increase in the number of microfinance organizations and credit unions that publish their financial reporting on a regular basis</p>
4.4	<p>Assist microfinance organizations and credit unions in obtaining low-cost wholesale financial resources and technical assistance from international donor organizations (loans, grants for acquisition of office equipment and so forth) by:</p> <ul style="list-style-type: none"> <li>- the participation of microfinance sector representatives at the annual Investment Forum of CIS countries (Moscow) and/or at annual international conferences organized by the Microfinance Center for Eastern Europe and CIS</li> <li>- organization of annual conferences with the participation of donors that provide commercial loans and technical assistance to the microfinance sector</li> </ul>	<p>Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)</p>	On-going	<p>Increase in the number of external funding sources</p>

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<sup>1</sup> [www.mixmarket.org](http://www.mixmarket.org)

	- publishing the experience of interaction between social investors and microfinance organizations of Kyrgyzstan			
4.5	Consider the possibility for Open-end Joint Stock Company “Settlement and Savings Company” to perform micro credit transactions out of its available deposit base, thus assigning a function of a wholesale service supplier for non-bank financial and credit institutions to Open-end Joint Stock Company “Settlement and Savings Company”	National Bank of the Kyrgyz Republic, Open-end Joint Stock Company “Settlement and Savings Company” (in coordination)	2006	Obtaining of a license by Open-end Joint Stock Company “Settlement and Savings Company” to perform credit operations
<b>5. Activities for building a market of supporting services and for strengthening microfinance infrastructure</b>				
5.1	Conduct activities on strengthening the role of associations of microfinance organizations and credit unions for the microfinance sector in order to assist in institutional capacity building of microfinance institutions, to assist in their sustainability, growth of professional reputation of their participants and coordination of microfinance sector needs.	Associations of microfinance organizations (in coordination)	On-going	Optimize the collection and exchange of information among microfinance institutions, provide access for microfinance institutions to the best international microfinance practice, represent the interests of the sector, render consulting services to microfinance institutions, organize trainings for representatives of microfinance institutions, introduce strict operational standards for

				microfinance institutions and so forth.
5.2	Establish an advisory center to render accounting, audit, consulting and training services within the framework of the Association of microfinance organizations to be established on the basis of dues from Association members, or technical assistance and grants from donors	Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)	2006	Establish an advisory center for microfinance organizations and credit unions
5.3	Create a data base with data about qualified consultants and trainers that will be contracted to train the employees of microfinance organizations and credit unions  Develop terms of references by Associations of microfinance organizations and credit unions on needs of the employees of microfinance organizations and credit unions in a particular training	National Bank of the Kyrgyz Republic, Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)	2006  On-going	Data base  Terms of References

5.4	<p>Assist microfinance organizations and credit unions (with the donor support) in the acquisition and/or modernization of information systems or accounting programs in order to computerize accounting entries and improve the efficiency of loan portfolio management</p> <p>Create (select) a local software supporting structure</p>	<p>“Financial Company for Support and Development of Credit Unions in Kyrgyzstan” Limited Liability Company (in coordination), Associations of credit unions (in coordination), German Development Cooperation Agency (in coordination)</p>	<p>On-going</p> <p>2006</p>	<p>Availability of information systems with market participants</p> <p>Presence of the maintenance department</p>
5.5	<p>Establish a microfinance resource center for the purposes of information exchange between microfinance organizations and credit unions, granting access to legislative and normative acts of the Kyrgyz Republic, dissemination of information about the best microfinance organizations within the country and abroad, provision of technical assistance to microfinance organizations and credit unions</p>	<p>Associations of microfinance organizations, Associations of credit unions (in coordination)</p>	<p>2006</p>	<p>Establishment of a microfinance resource center</p>
5.6	<p>Assist in adopting a draft law “On Credit Bureau” conforming to international standards on credit bureau</p>	<p>Ministry of Justice of the Kyrgyz Republic, Credit Information Bureau (in coordination),</p>	<p>2006</p>	<p>Promotion of the draft law “On Credit Bureau” in Jogorku Kenesh of the Kyrgyz Republic</p>

		European Bank for Reconstruction and Development (in coordination)		
5.7	Expand activities of a Credit Information Bureau through the assistance on submission of information by all microfinance service providers on a voluntary basis.	Credit Information Bureau (in coordination), Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)	Ongoing	An operating data base on borrowers of non-bank financial and credit institutions, and commercial banks
<b>6. Activities on coordinating the work of donors engaged in microfinance sector</b>				
6.1	Focus donors on the development of joint microfinance sector support programs	Ministry of Economics and Finance of the Kyrgyz Republic, National Bank of the Kyrgyz Republic, Association of microfinance organizations (in coordination), Associations of credit unions (in coordination)	On-going	Practical steps
6.2	Focus donors on the development of special programs supporting rural	Ministry of Economics and Finance of the Kyrgyz	On-going	Programs supporting rural financial and credit institutions

	microfinance organizations and credit unions	Republic, National Bank of the Kyrgyz Republic, Associations of microfinance organizations (in coordination), Associations of credit unions (in coordination)		
6.3	Attract international donors in order to assist microfinance organizations and credit unions in developing new products of microfinance organizations and credit unions, or modifying existing ones oriented at meeting clients' needs	Association of microfinance organizations (in coordination), Associations of credit unions (in coordination)	On-going	Increase of technical assistance from donors
6.4	Develop a credit union support program that will be the continuation of a technical assistance program supported by German Development Cooperation Agency	Ministry of Economics and Finance of the Kyrgyz Republic, Associations of credit unions (in coordination)	2006	Receipt of assistance
<b>7. Mechanism for monitoring Microfinance Strategy</b>				
7.1	Establish a working group for monitoring the implementation of the Medium Term Microfinance Development Strategy in the Kyrgyz republic comprising of representatives	Administration of the President of the Kyrgyz Republic (in coordination), National Bank of the Kyrgyz Republic,	2006	Establishment of a working group

	of public bodies, associations of microfinance institutions and international donor organizations	Office of the Prime-Minister of the Kyrgyz Republic		
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## **ANNEX 2. ANALYSIS OF THE MICROFINANCE SECTOR IN THE KYRGYZ REPUBLIC**

### **1. INTRODUCTION**

Compared to the other Central Asian countries, the microfinance sector in the Kyrgyz Republic is the most developed and is represented by different types of NFCIs. Thus, as of December 31, 2004 the system of NFCIs being microfinance providers consisted of: two specialized financial and credit institutions, the KAFC and the FCSDCU, 78 MCAs, 26 MCCs, 305 CUs and 116 pawnshops. The number of MCAs and MCCs has been rapidly growing: by the end of 2003 the National Bank of the Kyrgyz Republic has registered 72 MCAs and MCCs, one year later their number has increased to 104 MCAs and MCCs. With the support from international donors the so-called SHGs have evolved that are also microfinance providers.

Registration of MCAs and MCCs in the National Bank of the Kyrgyz Republic is a relatively simple process. This explains the large number of registered MFOs. Presently, these institutions can not be referred to sustainable MFOs, but in general, the presence of different types of microfinance providers can be considered an advantage. Different institutions attract different types of clients and enter into different niches. It contributes to a diversified supply of financial services, and on the whole, generates the necessary competition. It also allows understanding what type of providers meets best the market needs. However, most MFIs are small-scale organizations with distant perspective for growth. The average number of clients in MFOs is 200 (without FINCA), and in CUs is 100 participants.

The large number and the variety of MFIs pose problems for the supervisory body, the National Bank of the Kyrgyz Republic. In accordance with the legislation of the Kyrgyz Republic, the National Bank of the Kyrgyz Republic supervises all types of NFCIs. In this case, prudential regulation applies only to specialized NFCIs (FCSDCU and KAFC) and CUs, as well as MFCs that intend to or already accept deposits.

#### **1.1. KAFC**

KAFC is one of the largest financial and credit institutions with a portfolio in rural sector amounting to 1 517 million soms and more than 30 thousand clients. KAFC has 11 branches and 43 representations. KAFC is a financial institution with a number of strengths: trained managers, qualified staff, extensive lending experience, a large network in rural areas, and relatively diversified financial products. KAFC operates in the market with large demand and in this regard has the growth potential. The donor support has also contributed to the training of staff, the introduction of adequate information systems and the acquisition of equipment.

The average repayment rate for KAFC loans made up 97.3 percent for the past three years (2003-2005).

A major weakness in KAFC operations is the low sector diversification of the loan portfolio, which is almost 89 percent rural, with a focus on livestock.

KAFC has no sufficient own resources and is therefore strongly dependent on international credit lines.<sup>2</sup> KAFC has no right to attract deposits or offer other financial services such as electronic payments and transfers, foreign exchange operations. This limits the KAFC in offering a more complete service package to its 30 000 clients. KAFC considers that it is possibly losing its best clients that go to commercial banks. In order to solve this problem, the transformation into a fully regulated private deposit taking institution became a major objective.

## 1.2. Microfinance Organizations

The Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’ defines 3 types of MFOs: MCAs, MCCs and MFCs. MCAs, being non-profit organizations by their organizational and legal form are not subject to prudential regulation. MCCs, being commercial organizations are also not subject to prudential regulation. However, both types of these organizations must present their regulatory reporting to the National Bank of the Kyrgyz Republic on a semiannual basis.

MFCs, being joint stock companies are subject to prudential regulation by the National Bank of the Kyrgyz Republic from the date of presenting a commitment letter that confirms the intention of a MFC to obtain a license authorizing to accept deposits and to fulfill requirements of the National Bank of the Kyrgyz Republic. Clients of MCAs and MCCs, are, mainly urban residents, and the main products of these organizations are short-term working capital loans through individual and group lending.

A significant part of MFOs are small organizations that is the cause of their inefficiency. As per end of 2004 only 5 MFOs out of 104 MFOs had more than 1000 clients. 87 MFOs had less than 100 clients or had not been operating at all. 12 MFOs had between 100 and 1000 clients. The scale is essential for sustainable provision of micro credits. Presently, relatively high interest rates and low cost of loan funds enable most MFOs to survive, in spite of their small scale and inefficiency. This model, however, has its limitations. In order to become sustainable and achieve their mission of outreaching the poorest population, MFOs should grow. In this process, the limited resources are a major constraint.

A strategy to achieve that growth is merging. Mergers based on shared objectives can expand geographical coverage and client base, enhance cash flows and access to capital, and capture economies of scale, thereby reducing fixed costs. There are two examples of mergers in the country. MCA ‘*Bai Tushum*’ was established in 2000 by merging ACDI/VOCA and Caritas credit programs. In 2005 there had been a new merger of three MCAs supported by Mercy Corps into one MCC ‘*Financial Group Kompanion*’.

Most MFOs have small equity. They are not allowed to accept deposits, and they have no access to commercial sources of funding. Traditionally the sector depends on donors, and until now donor funds are deemed to be an excellent resource for the loan portfolio growth. As grant funds for loan portfolios are reducing, MFOs should work on alternative attraction of capital. One of the options is to obtain loans from wholesale providers that, in their turn, are financed from international sources.

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<sup>2</sup> Rabobank International Advisory Services: Strategy and Privatization plan for the KAFC. 2003. P. 3.

Small MFOs have a number of weaknesses<sup>3</sup>:

- 1) Poorly developed institutional framework. Governance structure is weak or inexistent. Management often has no financial or management background, or training;
- 2) Inadequately trained personnel, in particular, credit officers and personnel with accounting skills and knowledge of information systems;
- 3) Poorly developed lending procedures, the risk analysis is virtually non-existent;
- 4) Poorly developed loan tracking system;
- 5) Limited number of branches, mainly only a home office. Small MFOs generally focus on local communities where they are located that limits the outreach and the expansion possibilities;
- 6) No diversification of loan products.

Since MCAs and MCCs by their organizational and legal form are easy to establish, there are many people wishing to register this type of MFO, but at that not necessarily actively operating at the market. It partially explains why currently almost 40 percent of registered MCAs do not operate. It testifies about a large number of weak and inefficient MCAs and MCCs.

At the same time it shall be noted that there are good opportunities for MFOs to become more important microfinance providers. There is large unmet demand as indicated in paragraph 3 of this Annex; in particular, the market in rural areas (poor farmers, households) could become a potential niche. In order to be prepared to operate at this market, external assistance is required. In some countries there are donor supported facilities enabling to strengthen the institutional capacity and the efficiency of MFOs that encourages the achievement of sustainability in providing services to the poorest segments of the population<sup>4</sup>.

**Funding:** Newly established MFOs with small experience encounter problems due to the lack of funding. They can not attract deposits as they have no license and can not obtain funds from commercial sources as they have no credit history.

At young markets, with only few microfinance providers, donor funds can solve this problem. That was the case in the middle of 1990s when several NGOs started their operations with the donor support.

Since easy donor funds are limited, alternative sources are needed. Donors can play a role in bridging the vicious cycle of not having a credit history by bringing finance loans. In such a case, donors can provide resources to MFOs through wholesale providers of financial resources. By 2003 about one fifth of all resources for MFOs came from commercial banks in Eastern and Central Europe. The access to commercial credit will reduce dependence from donor funds. Donors can consider supplementary risk mitigating options to kick-start the loan access process. One such example is when

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<sup>3</sup> Source: results of regional round tables, interviews, SWOT analysis conducted by the National Bank of the Kyrgyz Republic.

<sup>4</sup> See for example the Financial Services Support Program in Pakistan funded by Swiss Development Cooperation.

donors have successfully provided loan guarantees enabling NGOs to borrow from commercial banks.

Another option could be for donors to help NGOs obtain loans from commercial sources by providing technical assistance for managing specific commercial loans.

### **1.3. Credit Unions**

CUs serve to a certain extent the rural areas. More than 300 CUs of the country established the most extensive network in Central Asia, serving about 30 thousand participants of CUs.

CUs have their own wholesale institution, the FCSDCU which over several years has been supervising CUs and providing them with institutional support. Based on ADB<sup>5</sup> recommendations, the supervision of CUs has been transferred to the National Bank of the Kyrgyz Republic in July 2005. Preparation to the privatization of FCSDCU has commenced.

The strength of CUs is their pursuit to improve their standing by combining efforts in order to facilitate independent economic activity.

CUs fulfill the objective of rendering assistance in improving social and economic standing of their participants by complying with the following basic principles of CU operations:

- self-help, self-governance and self-responsibility;
- joint liability of participants;
- identity, voluntariness and open membership;
- Autonomy and independence.

Participants of CUs self-regulate internal relationships of their union, and bear responsibility for the existence and the safety of a CU. Thereby, the system of CUs materially encourages the development of culture and self-responsibility.

Apart from that, the strength of CUs is, in principle, their location as CUs mainly operate in rural areas with no or little coverage by financial institutions. Some of them have used this advantage, but by the end of 2004 only 91 out of 305 CUs had more than 100 members and none of CUs had more than 1000 clients. CUs have a privileged tax situation when compared to MFOs.

In comparison with other MFIs, CUs have privileges in taxation.

As for weaknesses, it shall be noted that, to a large extent, the same weaknesses are inherent in them as in MFOs. Governance and management are major problems<sup>6</sup>. Capitalization is very low and members of CUs have limited possibilities to increase

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<sup>5</sup> CUs were established within the framework of the Credit Agreement between the ADB and the Government of the Kyrgyz Republic under 'Rural Financial Institutions' project.

<sup>6</sup> National Bank of the Kyrgyz Republic, SWOT analysis of NFCIs, 2004.

capital that reduce the amount of cash for on-lending. There are several CUs that do not fulfill certain financial indicators and some of them have past due debt to FCSDCU. There have been also fraudulent practices. There is a consensus that not all 300 CUs are viable and should be provided with technical assistance.

CUs have been set up with the intention to mobilize savings. In 2004 a pilot project took place whereby 10 selected CUs mobilized a total of Som 2.5 million. This pilot project was implemented by the National Bank of the Kyrgyz Republic with the support from GTZ project.

Presently, CUs are developing a strategic plan that will determine the future development of CUs and of its federative structure. In July 2005, CUs made a proposal to become the new owners of FCSDCU in case of its privatization.

## **1.4. Commercial Banks**

Two years ago commercial banks of the country were not visibly active in the market for micro and small lending. The EBRD MSFF has changed the situation dramatically. As part of a regional initiative implemented in Central Asia, it began its operations in the Kyrgyz Republic in April 2002. The main objective is to facilitate economic development of micro and small enterprises by ensuring sustainable access to credit resources for this target group.

Five banks: JSCB “Kyrgyzstan”, JSCB “Energobank”, CJSC “Ineximbank”, OJSC “Kazkommertsbank Kyrgyzstan” and OJSC “Halyk Bank Kyrgyzstan” are partners of EBRD MSFF. OJSC “Halyk Bank Kyrgyzstan” joined this group in the first half of 2005. In June 2005 these banks had a total of 44 lending outlets (small and micro loan departments) in Chui, Issyk-Kul, Jalalabad and Osh oblasts.

## **1.5. Poverty Lending and Self-Help Groups**

Information on lending targeted to reduce poverty was presented by UNDP that promotes SHGs within the poverty alleviation component of its Social Governance Program.<sup>7</sup>

SHGs are informal community based organizations at the village level. Internal savings system is fundamental for group self-reliance and for getting access to resources of financial institutions. SHG are engaged in saving mobilization to cover basic needs of their members. The group savings fund is used either for lending group members at average interest rates of 2-10 percent per month or for joint income-generating activities. Group savings come from membership fees, regular savings contributions, interests earned from lending, bank deposits and proceeds from joint activities.

By the end of 2004, some 1256 SHGs were operating in Kyrgyzstan<sup>8</sup>. According to the available data the savings propensity of SHGs has considerably increased. KAFC provides financial services to SHGs on the basis of group solidarity.

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<sup>7</sup> UNDP poverty pyramid gives a good idea about different poverty levels in rural areas.

<sup>8</sup> UNDP Annual Report, Kyrgyzstan on Poverty Reduction Component

## 1.6. Informal Finance

Mutual aid, referred to in Kyrgyz as *razha*, exists in most communities, whether poor or non-poor, rural or urban. The principle, generally, involves the practice of collecting small amounts of money (Som 30 to 500) from members of a given social network on the occasion of a wedding or funeral.

Such notion as *sherine or kassa* is also found in Kyrgyzstan. These informal groups consist of people who make regular cash contributions to a fund that is given in whole or in part to each contributor in turn. A worldwide phenomenon is when savings are rotated within the group, and credit associations are popular among the poorest segments of the population. The so-called *sherine* has become particularly popular among the non-poor. Amounts of up to Som 250 thousand are collected on a single occasion, and are used for the purchase of cars, expensive personal items, or to make investments. People who are relatively poor but have reliable income can participate in more modest *sherine* networks, to which they contribute only Som 100.

Informal finance might play an important role in rural finance.<sup>9</sup> Farmers receive in-kind finance from agricultural processors and repay it after the sale of their harvest. All farmer costs other than labor costs may be paid during the sowing period, where the grown harvest not the land serves as the security. While implicit interest rates may be relatively high, on-going relationships of this type keep reliability high and transaction costs very low. In this case the access to funding is the only constraint for farmers.

## 2. MICROFINANCE SUPPLY<sup>10</sup>

### 2.1. Non-Bank Financial and Credit Institutions

At the beginning of 2005 the National Bank of the Kyrgyz Republic sent questionnaires to NFCIs to confirm its interest in understanding this sector and its needs, to identify problems and elaborate required measures for further development. In addition, three regional round tables were held in July 2005<sup>11</sup> during which the problems of the microfinance sector and the proposed ways for their solution had been discussed.

**Table 1: Number of NFCIs**

Institutions	2001	2002	2003 <sup>12</sup>	2004	June 2005
KAFC	1	1	1	1	1
FSCDCU	1	1	1	1	1

<sup>9</sup> Even in the United States with its well-developed financial and agricultural markets, part of funding may come from informal sources, especially providers of inputs and processors.

<sup>10</sup> The National Bank of the Kyrgyz Republic is the main source of this information.

<sup>11</sup> These regional round tables (in Bishkek, Osh, Karakol) were organized by the National Bank of the Kyrgyz Republic in coordination with the consultants contracted by FIRST to prepare the Strategy.

<sup>12</sup> The National Bank of the Kyrgyz Republic started to register MFOs after adoption of the Law of the Kyrgyz Republic 'Micro Finance Organizations in the Kyrgyz Republic'.

MCA and MCCs	0	0	72	104	128
Credit Unions	278	349	303	305	312
<b>Total</b>	<b>280</b>	<b>351</b>	<b>377</b>	<b>411</b>	<b>442</b>

The group of MCAs and MCCs combines a wide diversity of institutions. FINCA, the largest micro finance institution in the country with over 20 thousand clients; MCC ‘*Financial Group Kompanion*’ has about 10 thousand clients; other MCCs have less than 100 clients. Similar differences are seen in micro credit agencies, where MCA ‘*Bai Tushum*’ is the only major provider (over 2 thousand clients).

Among CUs there are also considerable differences in terms of assets, portfolio, number of participants and performance.

Dividing NFCIs by the number of clients allows getting a better insight into the real importance of this sector. The breakdown presented in Table 2 shows four categories: Institutions serving less than 100 clients (small MFOs); institutions serving 100 to 1000 clients (medium) and large MFOs, institutions that have more than 1000 clients<sup>13</sup>. The fourth category refers to the registered but not operating institutions.

**Table 2. MCAs, MCCs and CUs (absolute number as of end of 2004):**

	<b>Small MFOs (&lt;100 clients)</b>	<b>Medium MFOs (100-1000 clients)</b>	<b>Large MFOs (&gt;1000 clients)</b>	<b>Non operating or not reporting</b>	<b>Total</b>
MCAs	34	12	3	29	78
MCCs	19	0	2	5	26
CUs	203	91	0	11	305
<b>TOTAL</b>	<b>283</b>	<b>86</b>	<b>5</b>	<b>35</b>	<b>409</b>

More than 75 percent of all registered MFOs and CUs are very small or not operating institutions while just over 20 percent of MFOs and CUs can be classified as medium institutions. Only 1 percent that is 5 MFOs have more than 1000 clients.

Large MFOs refer to FINCA, MCC ‘*Financial Group Kompanion*’ established at the beginning of 2005 by consolidating three MCAs established with the financial support from Mercy Corps and MCA ‘*Bai Tushum*’. They achieved operational sustainability and are interested in the transition to a new institutional stage where they can attract deposits: FINCA and MCA ‘*Bai Tushum*’ are on the road to transform into MFCs while MCC ‘*Financial Group Kompanion*’ intends to transform into a commercial bank.

**Loan Portfolio:** The loan portfolio of NFCIs (KAFC, MCAs, MCCs, and CUs) makes up 32.2 percent of the aggregate loan portfolio of CBs and NFCIs. As of December 31, 2004 the outstanding loan portfolio of NFCIs constituted Som 2 761 million while the loan

<sup>13</sup> The use of the terms small, medium and large is just for analytical purposes and does not refer to international standards in micro finance.

portfolio of CBs made up Som 5 816 million. The importance of NFCIs in terms of the number of clients is even more impressive: while the entire banking sector had 26 thousand borrowers as of end of 2004, NFCIs had over 93.7 thousand borrowers.

These figures show the dynamics in the development of the micro and small lending market and serve as a powerful argument in favor of professional attention to its development, including the drafting of the Strategy and its implementation.

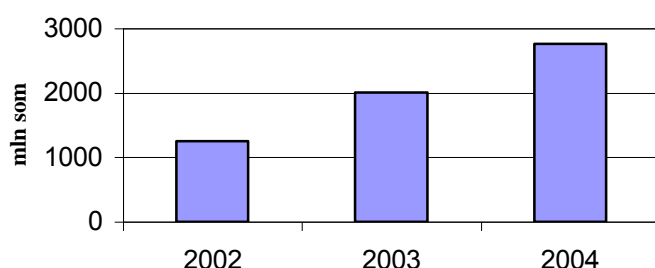
While the share of the loan portfolio of NFCIs in their assets constituted 83 percent, the share of the loan portfolio of commercial banks in their assets made up only 32.8 percent. Certainly, the low percent for banks is partially the result of prudential limitations imposed by the National Bank of the Kyrgyz Republic, but in this case, this difference shows that the money transferred to NFCIs reach clients in a more efficient manner than the money deposited at the banks.

Over the past two years, the portfolio of NFCIs has shown a steady growth, having increased twofold between 2002 and 2004. It is expected however that the rate of the loan portfolio growth will reduce in 2005 due to the lack of funds.

**Table 3: Outstanding loan portfolio of NFCIs (Som million)**

Name	31.12.02	31.12.03	31.12.04	Growth rate, % 2004/2003
KAFC	1.001	1.279	1.528	19
MFOs	-	434	785	81
CUs	249	289	449	55
Total	1.250	2.002	2.761	38

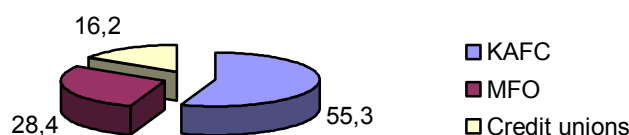
**Aggregate loan portfolio growth of NFCIs**



KAFC's portfolio amounts to 55.3 percent of the total loan portfolio of NFCIs. The loan portfolio of MCAs and MCCs constitutes 28.4 percent, and the loan portfolio of CUs is 16.2 percent. The portfolio of the four largest MFOs (FINCA, MCA 'Bai-Tushum', MCC 'Financial Group Kompanion' and MCC 'Leasing and Mortgage Company') amounts to 85 percent of the portfolio of all MFOs.

Chart 1. Aggregate loan portfolio of NFCIs, %





## 2.2. Commercial Banks

### 2.2.1. Background Information

The country's financial sector consists of 19 banks. Aggregate assets of banks made up Som 17.7 billion by the end of 2004. Total number of borrowers was about 26 thousand with the loan portfolio of Som 5.8 billion<sup>14</sup>. The financial intermediation index made up 6.2 percent (loans to GDP). It indicates that little cash is passing through the banks<sup>15</sup>. Though as compared to 2002 there is considerable improvement: in 2002 the financial intermediation index made up 2.7 percent. The National Bank of the Kyrgyz Republic presumes that by the end of 2007 the financial intermediation index will reach 9 percent<sup>16</sup>.

Deposits of the public made up Som 2.1 billion with 130 thousand savings accounts (5 million population).

In order to improve the confidence in the banking system, and following the example of Kazakhstan, Ukraine and Moldova, Kyrgyzstan is preparing a draft law on deposit insurance.

### 2.2.2. Banks and Micro finance

As it has been already mentioned 5 CBs: JSCB "Kyrgyzstan", JSCB "Energobank", CJSB "Ineximbank", JSCB "Kazkommertsbank-Kyrgyzstan" and JSCB "Halyk Bank Kyrgyzstan" operate under EBRD MSFF. By June 2005 these banks opened 44 lending outlets (small and micro loan departments) in Chui, Issyk-kul, Jalalabad and Osh oblasts

<sup>14</sup> These figures do not include the KAFC which is not a commercial bank. In terms of the loan portfolio it is the biggest financial institution in the country (Som 1527.7 million as of end of 2004).

<sup>15</sup> As a reference: the financial intermediation index for countries of Central and Eastern Europe stands at 35 percent. Source: CIS Banking Systems: Mixed Prospects but Common Risks, 2005.

<sup>16</sup> National Bank of the Kyrgyz Republic: Overview of projections until 2007.

MSSF partners banks provide 3 types of loans:

- Express loans amounting up to US\$ 2 000 within 2 days (as of December 31, 2004 their share made up 80 percent of the outstanding loan portfolio)
- Micro loans amounting between US\$ 2 000 and 10 000 (as of December 31, 2004 they occupied 18 percent of the outstanding loan portfolio)
- Micro and small loans – from US\$ 10 000 to 100 000 (as of December 31, 2004, they occupied 2 percent of the outstanding loan portfolio)

The credit methodology for micro and small lending has a lot in common with traditional micro finance methodology. In analyzing loan applications the cash flows are considered. Collateral is not required to obtain an express loan.

**Table 4. Portfolio of MSFF Partner Banks as of 31.12 .2004 (Som million)<sup>17</sup>**

Partner Banks	Total Outstanding Portfolio of Commercial Banks	MSFF Outstanding Portfolio	Share of MSFF Portfolio in the Portfolio of Commercial Banks	Current Number of Borrowers of Commercial Banks	Current Number of Borrowers under MSFF	MSFF Loan Portfolio to Loan Portfolio of Commercial Banks
Kyrgyzstan	757.7	178.9	23%	4 915	3 966	81%
Ineximbank	1 004.7	162.2	16%	5 067	2 683	53%
Energobank	552.9	62.4	11%	2 365	1 204	51%
Kazkommertsbank-Kyrgyzstan	855.1	66.6	8%	1 436	854	59%
Loan Portfolio of 19 banks	5 816.1	470.1	8%	26 249	8 707	33%

The portfolio is steadily and rapidly growing, and by July 1, 2005 it has increased by more than 50 percent up to US\$ 17 million<sup>18</sup> or Som 695.3 million, and the number of active borrowers has increased up to 11 867. The average loan size was less than US\$ 2,000 (as of January 1, 2005, the equivalent in som is Som 82.0 thousand) which is comparable to the average loan size in MCA ‘*Bai Tushum*’.

### 2.3. Outreach

As of end of 2004 the number of active borrowers of NFCIs and CBs operating under MSSF reached 102 241 borrowers. In comparing the number of borrowers with the number of households (1 107 thousand as of year-end), it may be noted that the coverage of households with loans made up slightly more than 9 percent.

<sup>17</sup> EBRD MSFF data (at the exchange rate of 31.12.2004, 1 USD = Som 41.6)

<sup>18</sup> At the exchange rate of 1.06.2005, 1 USD = Som 40.9

**Table 5: Number of borrowers as of 31.12.2004**

	<b>4 CB EBRD</b>	<b>KAFC</b>	<b>MCA</b> s	<b>MCC</b> s	<b>CU</b> s	<b>Total</b>
Borrowers	8 502	30 146	16 000	26 000	21 650	102 241

In 2004 the number of borrowers increased by 20 percent as compared to the last year. This shows that financial institutions dynamically expand their microfinance operations. There is a consensus that a large part of the demand remains unmet<sup>19</sup>.

### Geographical Distribution

The following table reflects data on the geographical distribution of borrowers among MCAs and MCCs.

**Table 6. Number of borrowers of MFOs by oblasts<sup>20</sup>**

<b>Oblast</b>	<b>31.12.03</b>	<b>31.12.04</b>	<b>Growth rate, %</b>	<b>Distribution of Borrowers by Oblasts 2004, %</b>	<b>Loan Portfolio Growth Rate, %</b>
Bishkek	5 191	8 064	55	19.2	137
Chui	1 214	2 573	112	6.1	99.6
Issyk-Kul	5 767	7 267	26	17.3	42.3
Talas	3 242	3 711	14	8.8	89.3
Naryn	2 206	1 436	-35	3.4	-31.1
Jalal-Abad	4 537	3 929	-13	9.4	45.8
Osh	7 914	11 719	48	27.9	98
Batken	4 884	3 244	-34	7.7	1.3
<b>Total</b>	<b>34 955</b>	<b>41 943</b>	<b>20</b>	<b>100</b>	<b>80.8</b>

### Distribution of the loan portfolio of NFCIs by sectors of economy

**Table 7. Loan portfolio of NFCIs by sectors**

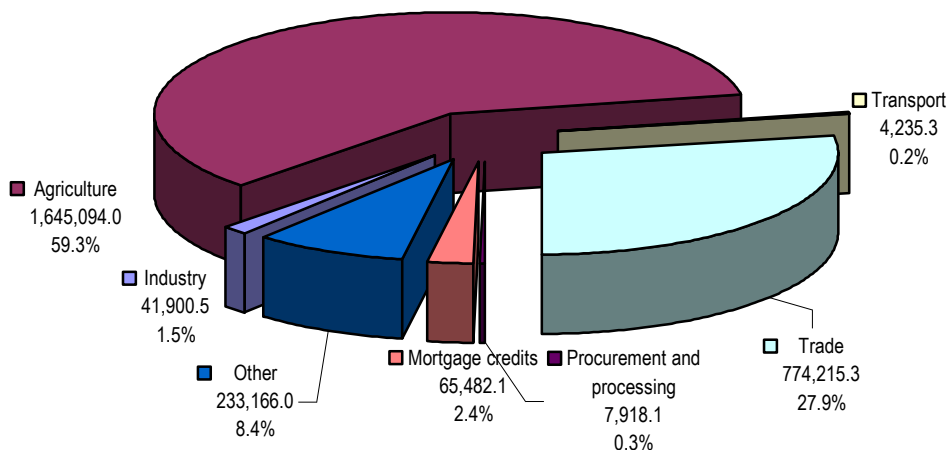
<b>Sector</b>	<b>Credits (million soms)</b>				
	<b>31.12.2004</b>	<b>%</b>	<b>31.12.2003</b>	<b>%</b>	<b>Absolute Change</b>
Industry	41.9	1.51%	21.6	1.10%	20.3
Agriculture	1645.1	59.35%	1502.1	74.70%	143.0
Transport	4.2	0.15%	4.3	0.20%	-0.1
Trade	774.2	27.93%	410.8	20.40%	363.4
Procurement and	7.9	0.29%	6.5	0.30%	1.4

<sup>19</sup> Information was gathered at three regional round tables (Bishkek city, Osh city, Karakol city, July 2005) organized as part of the Strategy development process.

<sup>20</sup> National Bank of the Kyrgyz Republic: Analysis. Document on the microfinance sector. 2005.

processing					
Mortgage credits	65.5	2.36%	6.5	0.30%	59.0
Other	233.2	8.41%	59.2	2.90%	174.0
<b>TOTAL</b>	<b>2772.0</b>	<b>100.00%</b>	<b>2011.0</b>	<b>100.00%</b>	<b>761.0</b>

**Aggregate Loan Portfolio of NFCIs as of 31.12.04  
by sectors of economy (thousand soms)**



As of 31.12.2004 the largest share of NFCIs' credits was issued to agriculture (59.3 percent) and to trade (27.9 percent). This is greatly determined by KAFC's rural oriented lending (89 percent of its portfolio). Without KAFC loans oriented at the development of agriculture, the distribution of the loan portfolio looks as follows: 54.7 percent for trade and 20.4 percent for agriculture.

If we only consider the distribution of the loan portfolio of MCAs and MCCs by sectors, then the trade prevails and represents 66.1 percent of the portfolio, and 72.4 percent of clients (see table 8). In the portfolio of MCAs and MCCs, the agriculture accounts comes to only 15.9 percent of clients and 12 percent of the portfolio. The share of industry, construction and services sector is very low.

**Table 8. Loan portfolio and number of borrowers of MCAs and MCCs by sectors of economy as of 31.12.2004**

	Active Borrowers (persons)	Share of Clients by Sectors	Loan Portfolio, million soms	Sector Share in Loan Portfolio
Industry	754	1.8%	27.2	3.5%
Agriculture	6 665	15.9%	93.9	12.0%
Trade	30 364	72.4%	518.3	66.1%
Construction	2	0.0%	36.8	4.7%
Services	1 409	3.4%	32.3	4.1%
Mortgage Loans	246	0.6%	51.8	6.6%

Other	2 503	6.0%	24.4	3.1%
Total	41 943	100%	784.7	100%

## 2.4. Performance Characteristics

This section briefly presents an overview of performance information by types of NFCIs and CBs implementing EBRD MSFF.

### Portfolio quality

Portfolio quality ranges between good to very good. On CUs the reduction in loan repayment is observed that is explained by past due debt on loans in individual CUs.

**Table 9. Repayment Rate Ratio of 31.12.2004<sup>21</sup>**

	5 Banks EBRD MSFF	KAFC	MCAs	MCCs	CUs
Repayment Ratio (%)	99	97.1	99	99	93.3

### Efficiency

The analysis of information on performance of NFCIs shows the low level of their staff productivity. In MCCs the average number of borrowers per staff member is 77. Excluding FINCA, which has 95 borrowers per staff member and the average number of borrowers in MCCs is reducing to 19.6 borrowers per staff member. Most MCCs have less than six borrowers per staff member that indicates an extremely low productivity.

Among MCAs, the average number of borrowers per staff member is 45. Again this is mainly influenced by one large provider – MCA ‘*Bai Tushum*’. The average for other MCAs is 26 clients<sup>22</sup> per staff member. Small MFOs typically have small number of staff members not exceeding three people.

Certainly, such low level of staff productivity negatively influences the efficiency and increases the costs per borrower. For MFOs it will be logical to grow in order to improve their productivity. But there are a number of bottlenecks that make this option realistic only for a limited number of CUs and MFOs. Most small microfinance institutions (CUs and MFOs) and there are almost 300 of them have no financial resources to grow, and they might never obtain them. Probably, most of them would not be able to considerably increase their portfolio and the number of borrowers to ensure proper efficiency<sup>23</sup>.

<sup>21</sup> On the basis of information from the National Bank of the Kyrgyz Republic. Percentages have not been verified.

<sup>22</sup> For comparison: MIX market provides detailed information (financial information, loan portfolio, performance) on more than 400 MFOs. This includes 54 MFOs from Central Asia and Eastern Europe which to a certain extent can be used as a point of reference in case of the Kyrgyz Republic. Please also see this at the following web-site: [www.mixmarket.org](http://www.mixmarket.org).

<sup>23</sup> Presumably, MFOs should have 1000 borrowers as a minimum to attain reasonable staff productivity: if 283 MFOs reach this level, the total number of borrowers could reach 283 000 that is 2.5 times more than the actual number of borrowers in microfinance institutions.

These circumstances indicate a considerable need for introducing more economical methodologies into operations of small CUs and MFOs. It is necessary to improve many aspects of their operations.

Other institutional weaknesses are also inherent in small CUs and MFOs. Although they mention the lack of financial resources as a major bottleneck in their operations, in reality the situation is much more complicated.

At the beginning of 2005 the National Bank of the Kyrgyz Republic sent questionnaires to MFOs in order to understand the situation in the sector as well as to review their strengths and weaknesses. This information was also analyzed and supplemented during the three regional round tables.

The low productivity is not a problem unique to the microfinance sector of Kyrgyzstan. In this respect it is possible to refer to a comparative study carried out by the Mix Market and the Microfinance Centre<sup>24</sup> that notes the low productivity of most MFOs in Eastern Europe and Central Asia. Given that MFOs in Eastern Europe and Central Asia offer a limited range of financial services and basically do not attract deposits, the real personnel productivity may be even lower than it appears. Partially low productivity is also observed among new MFOs of countries in Eastern Europe and Central Asia. African and Middle Eastern MFOs operate only slightly longer but the number of borrowers served by one loan officer/staff member is considerably higher. More likely, low productivity figures in the region are due to a higher concentration of individual loans, and relatively fewer group solidarity loans. As MFOs in this region begin offering a broader range of financial services, including more group loans, the productivity should begin to increase.

As a matter of fact, the average number of borrowers per staff member in countries of Eastern Europe and Central Asia amounts to 84 while the average figure is 136 worldwide. The best performers according to the MIX Market are DRC Georgia with 310 borrowers per staff member, followed by PRIZMA Bosnia (210 borrowers per staff member) and Aregak Armenia with 156 borrowers per staff member. Aurora Extreme (Russia) has about 9 borrowers per staff members and Mikrofond (Bulgaria) has 15 borrowers per staff member.

**Financial self-sustainability**

The biggest credit provider, KAFC, has been reporting profitable operations since 2001. As for other NFCIs, the situation is summarized below:

**Table 10. Profitability of MCAs (absolute number)**

	<b>Large</b>	<b>Medium</b>	<b>Small</b>	<b>Total</b>
Profitable	2	7	24	33
Break even	1	0	4	5
Not profitable	0	5	6	11
Not operating or non reporting				29

<sup>24</sup> Mix market and Microfinance Centre: Benchmarking microfinance in Eastern Europe and Central Asia. 2003.

**Table 11. Profitability of MCCs (absolute number)**

	Large	Medium	Small	Total
Profitable	2	0	7	9
Break even	0	0	1	1
Not profitable	0	0	11	11
Not operating or non reporting				5

**Table 12. Profitability of CUs (absolute number)**

	Large	Medium	Small	Total
Profitable	0	87	185	272
Break even	0	2	9	11
Not profitable	0	2	9	11
Not operating or non reporting				11

Only 50 CUs and MFOs report to be non-profitable in 2004 or breaking even based on its results. 314 out of 364 institutions that presented their financial statements to the National Bank of the Kyrgyz Republic report profit for 2004. It can be explained by the fact that NFCIs charge high interest rates that allow them to cover their operating costs even with a small loan portfolio.

### Self Help Groups

According to financial information presented to UNDP by individual SHGs, as of 2002 year-end, the total amount of their group savings made up Som 7.3 million. More detailed information is presented in table 13.

**Table 13. Savings in SHGs (Soms)**

2001				2002			
Total Savings	In cash	In kind	Bank Deposit	Total Savings	In cash	In kind	Bank Deposit
4 499 970	3 838 841	130 245	530 884	7 289 497	5 432 024	76 140	1 781 333

## 3. MICROFINANCE DEMAND

### 3.1. Introduction

A number of indicators indicate that there is unmet demand for micro credit in the country.

Firstly, it is an opinion of microfinance industry leaders and practitioners, and a number of experts.

“The major obstacles to continued growth by private farmers are low levels of technology, weak markets for agricultural inputs and outputs, low capitalization, and inadequate access to credit for working capital and equipment<sup>25</sup>”

A second indication is the information provided by the clients. Contacts with farmers, small enterprises and households have shown that the major part of them has no access to credits. In order to solve this problem, residents of villages and small towns set up CUs and MFOs. To a certain extent this reflects the expected need for credit. Here, there is not only demand for credit but to a greater extent there is demand for money. As in most countries, the population might have the demand for money but they are not always ready to become clients of MFOs. The following limiting factors hinder the development of lending:

- Low profitability of agricultural enterprises;
- Perception of a credit as a burden, a compromise that can have serious implications in case of non-repayment of debt (fear);
- a tradition of a barter;

Comparing the degree of population coverage by micro credits with other countries is a third indication that there is unmet demand. As table 14 shows, the outreach of micro credit constituted 2 percent as of 2004 year-end. This means that out of every 100 residents of Kyrgyzstan only two have access to a micro credit. In comparing this indicator with a similar indicator in other countries with a long micro finance development history, it appears that it is considerably lower which proves that there is room for growth. In Bangladesh, for example, 8 percent of population is covered by micro credits, in Bolivia with a 9 million population and 500 000 outstanding loans, the coverage constitutes 6 percent. It is clear that the high level of penetration is reached over a long period (micro finance in Bangladesh started more than 30 years ago, in Bolivia 20 years ago and 10 years ago in Kyrgyzstan).

However, it should be noted that Kyrgyzstan has the highest degree of population coverage by micro credits among countries of Central Asia. In such countries as Tajikistan and Uzbekistan, the outreach is less than 1 percent. Kyrgyzstan is also a leader in Central Asia in terms of the outreach to the poorest population, as pointed out in a study of the World Bank: “MFOs, in general, serve less than one percent of the total poor population and less than one percent of the rural poor population in each of the countries of Central Asia, except the Kyrgyz Republic where the outreach is 3 percent and 3.9 percent,<sup>26</sup> respectively”.

**Table 14. Coverage of the population by micro credits by oblasts**

	<b>Batken</b>	<b>Jalal-Abad</b>	<b>Osh</b>	<b>Naryn</b>	<b>Issyk-Kul</b>	<b>Talas</b>	<b>Chui</b>	<b>Bishkek</b>	<b>KR</b>
Population (thousand people)	413.7	947.6	1 033.40	265.5	426.4	212.1	752.8	790.7	5 092.80
Number of	7.5	15.2	27.4	7.5	16.6	7.4	9.8	11.1	102.2

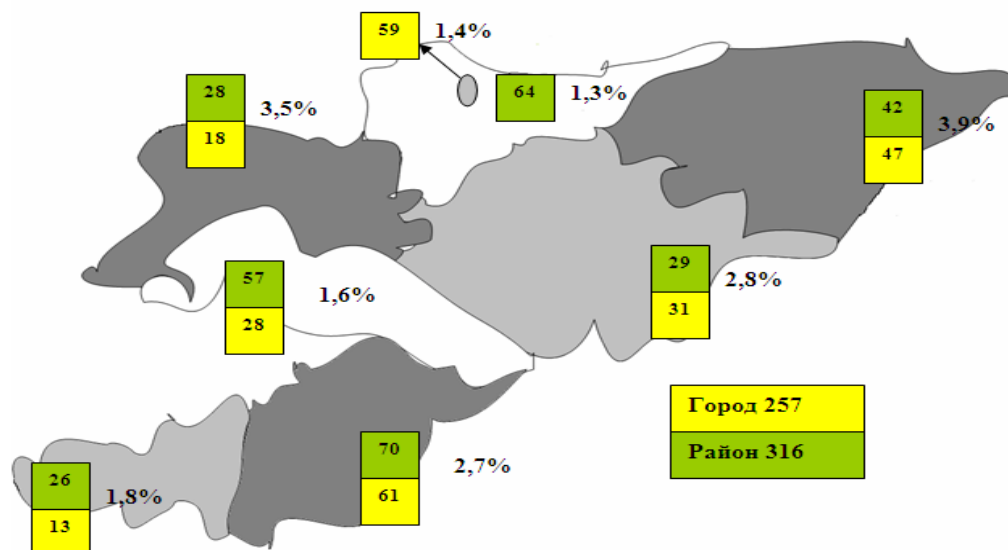
<sup>25</sup> World Bank: Stimulating agricultural growth through improved technology transfer, marketing and rural finance, p.1. Annex to “Kyrgyz Republic: Agricultural Policy Update, 2004”.

<sup>26</sup> World Bank: Micro finance and the Poor in Central Asia, 2004. p.11.



active borrowers of NFCIs and CBs (EBRD MSFF) thousand people									
Population coverage by micro credit (borrowers of NFCIs and CBs/oblast population)	1.8%	1.6%	2.7%	2.8%	3.9%	3.5%	1.3%	1.4%	2.0%
Home offices, branches, representative offices, CBs, MFOs and CBs operating under EBRD MSFF	39	85	131	60	89	46	64	59	573

The following loan coverage map gives data on the basis of 100 oblast residents and the number of home offices and branches of NFCIs and CBs operating under EBRD MSFF, and home offices and representative offices of KAFC, FCSDCU and data of CBs in each oblast.



Translation note: Please read in the box:  
Town 257 (yellow)  
Raion 316 (green)

Altogether microfinance providers have 257 home offices, branches and representative offices in Bishkek City, oblast capitals and in such major towns as Sulucta, Balykchy, Cholpon-Ata, Mailuu-Suu, Tash-Kumyr, Kara-Kul, and others. Especially because of credit unions, branches and representative offices of KAFC, most (39) raions of Kyrgyzstan are covered by microfinance services provided by 230 offices of these organizations.

Table 14 shows that the population in oblasts is differently covered by micro credits. The outreach in Issyk-Kul and Talas oblasts constituted 3.9 percent and 3.5 percent, respectively. In Naryn oblast with the highest level of the poor, the outreach is 2.8 percent that is higher than the outreach for the country. KAFC active presence is observed in these three oblasts. On the other hand, the outreach in Bishkek and Chui Oblast that appear to be more developed regions is lower than countrywide. This supports the fact that micro finance is greatly represented in rural regions.

However, the following information does not mean that the poor have better access to micro credits. The computation of the penetration indicator demonstrated the following:

**Table 15. Penetration by types of microfinance institutions<sup>27</sup> (2004)**

	<b>5 banks EBRD</b>	<b>KAFC</b>	<b>MCAs</b>	<b>MCCs<sup>28</sup></b>	<b>CUs</b>
Average loan amount (som)	54 000	50 677	18 501	16 310	20 721
Average loan amount (US dollars) <sup>29</sup>	1 298	1 218	445	392	505
Penetration (average loan amount/GDP per capita)	292%	274%	100%	88%	112%

GDP per capita in 2004<sup>30</sup>: Som 18.5 thousand.

These figures prove that microfinance has reasonable penetration. On the basis of MIX Market international standards, micro credit providers in Kyrgyzstan, as a rule, do not extend loans to the poorest segments of population<sup>31</sup>. One MCC ‘*Kyrgyzayltrust*’ that belongs to the group of medium MFOs in terms of the number of clients, serve the poorest households by providing loans on average Som 2 thousand per borrower. The average loan size for MCAs and MCCs makes up Som 15.9-20.1 thousand that are aimed to finance poor households. The loan penetration of MFOs loans makes up approximately 100 percent of GDP per capita.

As for the loans of banks operating under EBRD MSFF the penetration indicator of loans issued by these banks is virtually similar to the penetration indicator of KAFC loans. The average loan size in KAFC equals to Som 50.7 thousand that exceeds GDP per capita almost

<sup>27</sup> Source: The National Bank of the Kyrgyz Republic and the analysis of consultants.

<sup>28</sup> The average loan amount of MCCs is calculated without MCC ‘FRONTIERS’ and Leasing and Mortgage Company.

<sup>29</sup> 1 USD = Som 41.6

<sup>30</sup> Source: National Statistics Committee: Food security and poverty information bulletin. 2004.

<sup>31</sup> 4 loan categories as defined by the MIX Market: the loan size for the poorest < 20 percent of GDP per capita, the loan size for poor households is 21-150 percent, the loan size for medium households > 151-250 percent, the loan size for small businesses > 250 percent.

threefold, and makes up 274 percent<sup>32</sup> that is largely conditioned by the presence of large loans in KAFC's loan portfolio. The average loan size in KAFC indicates that their clients are not small farmers. 80 percent of loans extended by banks under EBRD MSFF are express loans with the value not exceeding US\$ 2000 (as of January 1, the equivalent in som – Som 82.0 thousand).

## 3.2. Estimating the Unmet Demand

### General Information

In view of the growing microfinance market, a detailed analysis of the demand for loans is required. The computation of the demand for loans is conducted on the basis of a number of presumptions and assumptions.

For the analysis there have been distinguished four categories of borrowers that have the demand for loans and can expand the market for microfinance providers. By determining the demand of these four categories of borrowers, the growth potential for the Kyrgyz microfinance market can be described for the period in question 2006-2010.

Four categories that have unmet demand for loans, are as follows:

- 1) farmers and enterprises;
- 2) poor households;
- 3) active clients of microfinance organizations;
- 4) Micro enterprises.

The demand for loans of commercial banks has also been taken into account in the analysis. For the past two years, the loan portfolio of CBs under EBRD MSFF has considerably increased, and the projections are such that this growth will continue during next years.

#### A) Unmet demand from farms and enterprises

**Table 16. Coverage of economically active population, enterprises and farms with loans issued by microfinance institutions as of 31.12.2004<sup>33</sup>**

	Batken	Jalal- Abad	Osh	Naryn	Issyk- Kul	Talas	Chui	Bishkek	Kyrgyz Republic
Population (thousand people)	413.7	947.6	1 033.40	265.5	426.4	212.1	752.8	790.7	5 092.80
Number of									1 109 716

<sup>32</sup> Penetration

<sup>33</sup> Source: The National Bank of the Kyrgyz Republic, the National Statistics Committee and computations made by the Strategy development team.

households									
Number of economically-active population	162 599	375 078	520 269	103 383	166 222	88 488	362 221	398 500	2 176 760
Number of enterprises	2 079	481	1 112	155	359	146	1 083	5 311	8 859
Small	167	376	971	128	279	125	874	4 808	7 729
Medium	24	64	87	17	50	19	139	352	756
Large	16	41	54	10	30	2	70	151	374
Number of individual entrepreneurs	8 796	13 618	33 387	7 629	18 657	4 098	25 746	34 482	146 413
Number of farms	35 492	66 796	34 809	33 692	21 766	16 587	35 442	96	259 701
Number of enterprises/number of economically-active population per oblast	1.3%	0.1%	0.2%	0.1%	0.2%	0.2%	0.3%	1.3%	0.4%
Number of farms/number of active population per oblast	21.8%	17.8%	6.7%	32.6%	13.1%	18.7%	9.8%	0.02%	11.9%
Number of borrowers in NFCIs and CBs (EBRD MSFF)	7 446	15 162	27 346	7 493	16 581	7 351	9 775	11 087	102 241
Number of borrowers in NFCIs/total population per oblast	1.8%	1.6%	2.7%	2.8%	3.9%	3.5%	1.3%	1.4%	2.0%
Number of KAFC borrowers	2 640	4 962	3 320	3 178	4 300	2 580	4 050	116	25 146
Number of KAFC borrowers/number of farms	7.4%	7.4%	9.5%	9.4%	19.8%	15.6%	11.4%	120.8%	9.7%

Coverage of the population by loans (expressed as the number of borrowers/the population per oblast) is the highest in Issyk-Kul (3.9 percent), Talas (3.5 percent) and Naryn (2.8 percent). The highest coverage of farms by KAFC loans is observed in Issyk-Kul oblast (19.8 percent).

It shall also be noted that the lower loan coverage of the population is observed in Chui Oblast and in Bishkek than on average for the country. It is not an ordinary situation as usually the loan coverage of the population is the highest in the capital and neighboring raions. The reason for this is the specific character of KAFC lending being one of the largest provider of financial services that targets its resources to lending agricultural commodity producers in the republic’s regions.

Certainly, not all resources are dedicated for lending farms and enterprises. The portion of group loans in MCCs and MCAs, and the portion of loans in CUs are allocated for funding households. The analysis has shown that the household oriented loans constitute 40 percent of the loan portfolio of NFCIs and CBs, the remaining 60 percent are dedicated for lending farms and enterprises. This means that approximately 15 percent out of all 268 560 enterprises and farms are covered by loans (see table 16: 8 850 enterprises and 259 701 farms). The increase in the coverage between 60 to 80 percent will mean an additional demand for 30-50 thousand loans. Given the average loan amount of Som 32.8 thousand, **the demand for loans will be Som 984- 1640 million.**

Probably, the average loan amount for the certain part of these new borrowers will be lower as in expanding the coverage, small farms and entrepreneurs that to date have been of no interest to the microfinance providers, will be included in the number of new borrowers.

**B) Unmet demand of poor households for loans**

Another market segment is the unmet demand for loans of households that are not registered as farms and individual enterprises (i.e. those engaged in micro business). They need these loans to conduct commercial and production operations, for consumer purposes and so forth.

On the basis of available information it follows that there is strong unmet demand for consumer loans. To date it is a poorly explored market that is of interest for MFOs as it allows for diversification of risks from production operations. Several studies have pointed at that fact that the poor are interested in loans that are not related to the production. The research by a large Indian Bank NABARD, being a wholesale supplier, cites the following opinion of self-help groups “Consumers loans, savings, loans for production and insurance were the priority for many poor. Consumer needs included loans for short periods of time for unforeseen situations”.

In order to estimate the potential demand, the population has been classified into 3 categories:

**Table 17. Classification of households by poverty level (2003)**

Poverty Level	% of population <sup>34</sup>	Households <sup>35</sup>
Above poverty level	60.7%	607 000
Poor	30.8%	308 000
Extreme poor	8.5%	85 000

<sup>34</sup> Information of the National Statistics Committee of the Kyrgyz Republic

<sup>35</sup> Approximate figures based on 1 million households

According to the presumptions, the potential market for microfinance providers is approximately between 70-90 thousand households on the assumption of the following two conditions:

- the households that are above poverty level will borrow exclusively from commercial sources;
- 25 to 30 percent of poor households have unmet demand for some form of consumer loans or loans for other special purposes, and have income enabling them to repay consumer loans.

Given the average loan size of Som 10.4 thousand per household, the potential volume of loans will make up Som 700-900 million.

### **C) Growth of the demand for loans among active clients of microfinance institutions**

The practice in Kyrgyzstan has shown a high level of repeat borrowing (71 percent of clients apply for a new loan to the same organization after the loan repayment)<sup>36</sup>. This high percentage of repeat borrowing can attribute to the relatively low competition (few alternatives) but also indicates the degree of satisfaction with microfinance services.

Average outstanding loan amount of NFCIs (MCAs, MCCs, KAFC, CUs) in 2004 made up approximately Som 32 thousand.

The demand for loans for this category of borrowers will be between Som 3 700 – 6 650 million on the basis of the following facts and conditions:

- Availability of more than 100 thousand borrowers of NFCIs as of 2004 year-end (enterprises, farms and households);
- The growth rate of the outstanding loan portfolio of NFCIs on average will make up 10-20 percent per year that will result in the average loan amount per client at Som 62-48 thousand in 2010 (repeat loans and new loan products for the same clients);
- By 2010 the number of clients of microfinance organizations will be between 60 000 and 80 000 (the increase in the number of MFO borrowers will slow down due to the transfer of MFO borrowers, whose needs outgrew micro credits, to banks).

### **D) Loans of CBs to micro enterprises**

The loan portfolio of CBs operating under EBRD MSFF made up Som 470 million by the end of 2004. Taking this into account, the EBRD plans to invest additional US \$ 30 million into this facility (as of January 1, 2005, the equivalent in som – Som 1 250 million). To date CBs participating in the facility note strong unmet demand for loans. The moderate growth rate of the loan portfolio at 25 percent per year will result in the loan portfolio of Som 1 790 million that will be more than 40 million in dollar equivalent. At the annual growth rate of 40 percent, the loan portfolio will make up Som 3 530 million, or 85 million in dollar equivalent by 2010.

## **CONCLUSION**

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<sup>36</sup> World Bank: Micro finance and the poor in Central Asia, p. 19.

Thus, by summarizing the demand for loans from four categories of borrowers, the following projections have been obtained:

**Table 18. Projection of the demand for loans**

CLIENT GROUP	Loan Portfolio 2004, Som million	Projections of the Demand for Loans of MFIs 2010 (Som million)		Annual Growth in %	
		Low	High	Low	High
Loans of new clients for production purposes	0	984	1 640		
Loans to poor households	0	700	900		
Loan portfolio of NFCIs	2 772	3 700	6 650		
Loans of CBs (EBRD MSFF)	470.1	1 790	3 530		
Total	3 242.1	7 174	12 720	13%	21%

The table shows the low-end and the high-end projections of the demand for loans extended by microfinance institutions and their annual growth rates.

In order to achieve the low and the high-end scenarios it is required to ensure the annual portfolio growth of MFIs by 13 percent and 21 percent, respectively. In view of the portfolio growth of NFCIs for the past several years, and the international growth experience of young microfinance markets, even the high-end projections appear to be probable.

Certainly, the achievement of this growth will depend on the availability of funding and on the adequate institutional capacity building of microfinance providers.

## Savings

The starting point for the analysis is the monetary savings of the population in the banking system. As Table 19 shows, the total savings as of 2004 year-end amounted to more than Som 10 billion that is approximately 11 percent of GDP.

This level of savings is lower if compared with some CIS countries, for example, it is 17 percent in Russia, in Ukraine – 20 percent and in Kazakhstan – 16 percent<sup>37</sup>). However, if we compare this indicator with the similar indicator for 2002 then we can assuredly note the improved public confidence in the banking system. The level of savings was 4 percent in 2002.

**Table 19. Volume of Deposits in the Banking System of the Kyrgyz Republic**<sup>38</sup>

Types of Savings	31.12.2003	31.12.2004	30.06.2005
Demand deposits of legal entities (Som million)	2 618.32	4 718.36	5 589.87

<sup>37</sup> Savings in South and East Asia are 30-40 percent, 17-30 percent in Europe.

<sup>38</sup> Source: The National Bank of the Kyrgyz Republic. Savings in commercial banks and SSC. US\$ 1 = Som 41.

Deposits of physical entities (Som million)	1 429.25	2 081.12	2 085.08
Time deposits of legal entities (som)	733.46	1 142.85	1 723.58
Government deposits (Som million)	187.96	225.45	793.87
<b>Total Som million</b>			
Total Som million	4 968.99	8 167.78	10 192.39
Total in terms of US\$ thousand	121 194.8	199 214.2	248 595.0
<b>Total savings of physical entities in terms of US\$ thousand</b>			
Total savings of physical entities in terms of US\$ thousand	34 859.8	50 759.0	50 855.7

As of 2004 year-end, the savings of physical entities made up more than Som 2 billion. It is approximately 133 000 demand deposit accounts and 13 000 time deposit accounts. The average balance on these accounts was Som 14.5 thousand.

The level of private savings has considerably increased in 2004 as compared with 2003 (see table 19).

There is continued low level of public confidence in CBs. The evidence of such lack of confidence is that fact that the population, especially in rural areas prefers to make savings in non-monetary form by purchasing livestock<sup>39</sup>.

Mobilization of savings from the public was one of the major objectives of CUs established in the second half of 90s was. During 2003-2004, 10 CUs participated in the pilot project by obtaining a temporary license of the National Bank of the Kyrgyz Republic and attracted Som 2.5 million.

In spite of doubts raised by the expected low savings capacity of the population, several largest NFCIs plan to transform into deposit taking institutions. It is also expected to privatize KAFC with the follow-up transformation of this institution into a CB.

### **Determining the need in savings services**

Currently, CBs and SSC are major institutions offering savings services in Kyrgyzstan. These institutions render savings services to 146 000 physical entities. Assuming that this figure represents the number of households, the coverage with savings services will amount to 14 percent (approximately 1.1 million households<sup>40</sup>). By comparing this indicator with the coverage of the population by savings services in other countries, we can draw a conclusion that there is scope for further growth. At this state it is impossible to estimate the gap in the required types of services, in particular, for poor segments of the population and small farmers.

This issue requires an additional detailed research. A countrywide study would help to understand the potential for mobilizing savings and the existing barriers. The worldwide experience shows that the poor are capable to save, and that the access to safe and easily available savings facilities is often considered to be more important for this category of the population than the access to loans.

<sup>39</sup> FACET BV: Report on the financial sector in the Kyrgyz Republic and Kazakhstan. 2003.

<sup>40</sup> Information of the National Statistics Committee



## **ANNEX 3. ANALYSIS OF LEGAL AND REGULATORY MICROFINANCE ENVIRONMENT**

Fair and even treatment of all financial and credit institutions (hereinafter referred to as FCIs) is the key principle of the analysis in the legal and supervisory structure, as among FCIs that are engaged in microfinance and use standard micro finance methodologies there should be no discrimination in legislation and taxation. For supervisory purposes, micro finance should be considered as a special category that is different from traditional banking, and a less conservative approach should apply to it.

### **1. NORMATIVE AND LEGAL FRAMEWORK FOR MICROFINANCE ACTIVITIES**

All FCIs engaged in microfinance are guided by the following:

- General legislation of the Kyrgyz Republic (Civil Code of the Kyrgyz Republic, Tax Code of the Kyrgyz Republic, Law of the Kyrgyz Republic ‘*On Pledge*’, Law of the Kyrgyz Republic ‘*On Joint Stock Companies*’ and others);
- Banking legislation (Law of the Kyrgyz Republic ‘*On Banks and Banking Activity in the Kyrgyz Republic*’);
- Special laws of the Kyrgyz Republic (‘*On Microfinance Organizations in the Kyrgyz Republic*’, ‘*On Credit Unions*’);
- Normative acts of the National Bank of the Kyrgyz Republic regulating their activities.

### **2. LEGISLATION ANALYSIS**

Overall, the normative and legal framework creates conditions that enable FCIs to provide microfinance services without any major restrictions. The Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’ defines a clear framework for implementing microfinance activities both by commercial organizations and not-for-profit organizations. MFOs independently set their interest rates and fees. Moreover, the Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’ does not set the size of a micro credit thus enabling MFOs to develop a wide range of loan products and diversify their loan portfolio. Capital requirements for microfinance companies are considerably lower than the capital requirements for CBs. Comparison with the international experience shows that the ratios in Kyrgyzstan comply with the standards accepted in other countries in the area of microfinance regulation (Bolivia, India, Kenya, Peru and Tanzania<sup>41</sup>).

The microfinance sector is dynamically developing, therefore, the legal environment should be dynamically developing in the same manner in order to meet the changing needs of the sector.

This annex presents a detailed analysis of the legislation framework that has been conducted in order to identify gaps in legislation that need to be addressed in the short and medium term.

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<sup>41</sup> See Stefan Staschen: ‘Regulatory Requirements for Microfinance. A comparison of legal frameworks in 11 countries worldwide’, GTZ, 2003 and the comparative database on microfinance regulation [http://microfinancegateway.org/resource\\_centers/reg\\_sup/micro\\_reg](http://microfinancegateway.org/resource_centers/reg_sup/micro_reg)

Legislation framework analysis can be conditionally divided into six topics:

1. Transformation of MCAs/MCCs into MFCs;
2. MFCs and CBs;
3. CUs;
4. Taxation Issues;
5. Collateral registration and impressment
6. Functioning of credit bureaus

## **2.1. Transformation to a Microfinance Company**

**Ownership share:** Article 13 of the Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’ limits the share interest of one shareholder in the capital of a microfinance company to 20 percent. Exceptions include international organizations specified in the list of the Interim Regulation ‘*On Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic*’, approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #42/1 of 14.10.2002. This limitation has been introduced to diversify MFC owners and to ensure a governance structure in line with corporate principles.

In this connection MCAs/MCCs transforming into MFCs should attract, at least, another four investors prior to obtaining a license. The international experience shows that at the early stages of microfinance development it is difficult to attract local investors. MFOs have to address international social investors. An objective to mobilize funds exceeding the amount of own capital by four times<sup>42</sup> is quite challenging and might require several years to implement. Rapid transformation without careful selection of co-owners may jeopardize the original mission of the organization.

The assessment of the current capacity in organizations shows that MCAs and MCCs willing to transform into MFCs will encounter this problem.

In this context, the National Bank of the Kyrgyz Republic plans to consider the possibility of introducing changes to the List of International Organization in the Interim Regulation ‘*On Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic*’ or setting a transition period (3-5 years) for founders of MFCs, during which the share interest of one shareholder in the capital will be in line with a 20 percent limitation.

In order to permit CBs to establish MFOs and perform microfinance activities, the possibility will be considered to introduce changes to paragraph 3 of Article 31 of the Law of the Kyrgyz Republic ‘*On Banks and Banking Activity in the Kyrgyz Republic*’ that limits the size of any investments of CBs in non-bank organizations, and Article 13 of the Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’ that restricts the share interest of legal entities in the capital of MFOs.

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<sup>42</sup> The Mix Market currently lists 68 private and donor-related investors that invest in microfinance sector worldwide.

**Transfer of assets:** MCAs do not have the possibility to transform from a not-for-profit organization to a commercial entity (MCC or MFC). MCAs willing to transform into a MCC or MFC should establish a new legal entity. The transfer of assets to a commercial entity is considered to be income ‘*without compensation*’<sup>43</sup> and is subject to tax. As a result, MCAs willing to transform must find complex solutions choosing between a public foundation and a new company to avoid the taxation of the transferred capital. Moreover, the transfer of the credit portfolio is rather a complicated and an expensive procedure as it includes the payment of fees to the notary office for registering each transfer. In this case, the assets transferred to a new commercial legal entity will be used for the same purpose as previously (for combating poverty) therefore the taxation and the payment of administrative fees in terms of a new company is unjustified.

In this connection it is necessary to:

- Simplify the transfer of assets, including loans from a MCA, being a not-for-profit organization to a commercial MCC/MFC;
- Introduce changes to the Tax Code of the Kyrgyz Republic in order to exempt the transferred capital from tax.

**Charter capital and registration:** In accordance with Article 14 of the Law of the Kyrgyz Republic ‘*On Microfinance Organizations in the Kyrgyz Republic*’, the minimum charter capital should be deposited on the account in a CB prior to obtaining a license. The approval process takes, at a minimum, 30 days, and unproductive custody of Som 10-25 million during the term of application consideration is connected with considerable costs for the organization. Moreover, the re-registration from a MCA/MCC to a MFC will take time during which a new legal entity will not be able to issue loans that will also make the organization to incur enormous costs. Interruption in lending operations will have a negative impact on the client’s perception of a new MFO.

Only newly established MFCs, MCAs and MCCs should be required to deposit the charter capital. There should be exemption mechanisms from this requirement with respect to a MCA/MCC transforming into a MFC as the National Bank of the Kyrgyz Republic has the possibility to monitor the financial standing during the period prior to the submission of the application in order to ensure compliance with the minimum capital requirements.

**Staff Requirements:** In accordance with the Interim Regulation ‘*On the Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic*’<sup>44</sup>, the qualification requirements imposed on employees of CBs apply to key positions in MFCs, including the Board of Directors, the managing director and the managers of main subdivisions. According to these requirements, persons appointed for these managing positions must have experience in the banking sector for several years. It will be logical if these requirements take into account not only banking experience of the candidates for managing positions, but also their work experience in the microfinance sector, as for example, in Pakistan<sup>45</sup>.

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<sup>43</sup> Tax Code of the Kyrgyz Republic – Article 93 (3e)

<sup>44</sup> Subparagraph 7 of paragraph 4.2 and paragraph 5.5. of the Interim Regulation ‘*On the Establishment of Microfinance Companies on the Territory of the Kyrgyz Republic*’, approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #42/1 of 11.10.2002 (registration number of the Ministry of Justice of the Kyrgyz Republic #143-02 of 14.11.2002).

<sup>45</sup> “The chief executive shall be professional with sufficient experience as a Microfinance specialist or a Senior Banker ...Annex II, Draft Guidelines on NGO Transformation, Central Bank of Pakistan, 2004

## 2.2. Microfinance Companies and Commercial Banks

CBs of Kyrgyzstan increasingly scale-up their microfinance operations and consider it as a new type of business enabling them to diversify services and attract new clients. In other countries, CBs usually do not address microfinance issues. From the regulatory perspective this development poses a new challenge on how to manage the microfinance portfolios of CBs. International consensus is moving towards the principle that supervisory norms and instruments should be developed on the basis of classification of portfolio risks and the specific character of microfinance. These norms should apply to all institutions addressing microfinance issues irrespective of the type of the financial and credit institution.

**Differences between microfinance portfolio and traditional lending portfolio:** Regulation ‘*On Lending in Commercial Banks and Other Financial and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic*’, approved by the Board of the National Bank of the Kyrgyz Republic #12/7 of 27.04.2005 sets requirements to credit policies of CBs, KAFC, FCSDCU and deposit-taking MFCs. The regulation involves three issues that can create impediments for microfinance activities:

- In accordance with paragraph 5.3.11 ‘blank credits’ or unsecured credits can only be provided to borrowers with a perfect credit history for, at least, two years. If group lending or alternative pledge lending methodologies will be considered as unsecured credits then this regulation restricts commercial banks and MFCs in using such techniques;
- Paragraph 5.3.11 also restricts unsecured loans to 50 percent of net capital that can become a major bottleneck for larger MFOs that intend to transform into MFCs in the nearest future;
- Paragraph 6.7 requires the monitoring of the pledged property on a monthly basis. For credit officers that manage, at a minimum, one hundred individual clients, it will not be feasible to fulfill the requirement of monthly visits to each client. The normal practice is to visit problem clients frequently, and the remaining clients are visited quarterly or semi-annually.

Thus, the Regulation ‘*On Lending in Commercial Banks and Other Financial and Credit Institutions Licensed by the National Bank of the Kyrgyz Republic*’ does not differentiate between the traditional lending portfolio and the microfinance portfolio by restricting microfinance activities for both CBs and MFCs, thereafter it is necessary that:

- ⇒ Portfolios based on proven micro finance methodologies (for example, group lending and cash flow based lending) should not be considered as unsecured, thereby the applicable restriction of 50 percent of net capital for unsecured credits should be mitigated;
- ⇒ The requirement for monthly monitoring of collateral should be excluded. The principle should be that the frequency for monitoring the pledged property should be determined by banks and financial institutions on the basis of risk level.

The Regulation on Asset Classification and Appropriate Allocations to the Allowance for Loan Losses for banks, SSC, KAFC and FCSDCU also does not into account the data on micro credit risks if compared with traditional lending.

Currently, CBs participating in the EBRD MSFF are negotiating with the National Bank of the Kyrgyz Republic the issue of classification of ‘express loans’. These are the loans under US \$ 2000<sup>46</sup> issued against the pledge of movable property without title documents and appropriate execution. In accordance with the Regulation on Asset Classification and Appropriate Allocations to the Loan Loss Reserve, the National Bank of the Kyrgyz Republic classifies these products as loans ‘under observation’ due to insufficient security. At the same time, the repayment rate has been 99 percent for the past two years, and CBs argue that at the time of issuance of these loans, the risk level is not higher than the risk level on traditional loans, and they should be classified as ‘satisfactory’.

Furthermore, the best microfinance provisioning practices are based on the principle that micro credits with an average repayment indicator over 95 percent do not automatically pose considerable risk, consequently there is no need for automatic provisioning. However, in case of past due payments, a financial institution should create a relatively high provision based on a more accelerated method in contrast to traditional lending in view of the absence of qualitative collateral.

***Experience of other countries***

Provisioning rules should be determined on the basis of activities in this case the same rules should apply to banks and deposit-taking MFCs. Microfinance with a good history of application should be determined using alternative lending methodologies, for example, group lending and cash flow based lending. Risks will be reduced through the combination of lending methodologies and strong monitoring systems, including staff, strict procedures and qualitative loan tracking system, and internal controls. Rules of establishing ALL for microfinance portfolios should stipulate lower reserves for loans with good repayment rate, and relatively higher reserves for clients with past due payments. The limit of US \$2 thousand is proposed as an upper threshold.

	<b>Loans &lt; \$2000</b>
Normal	0-2 %
Satisfactory	2%
Under Observation	10%    5 - 30 days
Substandard	50%    31-60 days
Doubtful	100%    61 – 90 days
Losses	100%    > 90 days

The existing practice in terms of loan amounts applied within the framework of micro finance methodologies in Kyrgyzstan can serve as a good indicator in determining the amount.

**Branches and units:** Currently MFOs can open branches and units by notifying about their intention the National Bank of the Kyrgyz Republic, and provided that the financial standing of the organization enables such expansion. CBs should complete a more extensive procedure to obtain an authorization for opening a branch, however, each branch can open a smaller unit called a savings office by notifying the National Bank of the Kyrgyz Republic.

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<sup>46</sup> In the oblasts the maximum loan amount is US \$1000.

Savings offices can accept savings deposits and issue loans, however, they can not make credit decisions. Presently CBs participating in the EBRD facility begin to expand the outreach by covering rural regions. Where the demand is not sufficient to operate a profitable branch, the low-cost savings offices are opened. CBs encounter difficulties in searching for staff members that meet the requirements of the National Bank of the Kyrgyz Republic set for employees of savings offices, and willing to live in a rural region. Furthermore, savings offices have no right to make credit decisions that increase operating costs of CBs and increase travel expenses for clients.

Currently, large MFOs operate through branches (often part-time) in rural areas. Depending on the future development of the normative base, organizations transforming into MFCs might encounter restrictions for operating their network in rural regions.

An association of CBs should develop a detailed proposal to review costs associated with different units. An alternative option is that banks establish MFCs as fully owned subsidiaries of CBs that enable them to carry out microfinance activities in accordance with the ratios for MFCs.

**Deposit Insurance Scheme:** After a long development process, it is expected that the draft law on deposit insurance will be approved within the specified time frames. CBs consider the implementation of this scheme as a prerequisite for increasing large-scale deposit mobilization in the country.

### **2.3. Law of the Kyrgyz Republic 'On Credit Unions'**

**Growth limitation:** Currently, CUs cannot attract deposits and the maximum amount<sup>47</sup> of external borrowings exceeds the amount of their own capital by four times. Under such rules the growth perspectives are limited for CUs, and several unions have transformed into MCAs/MCCs to avoid limitations on external borrowings.

Due to identified violations and fraudulent practices in operations of CUs, the number of license revocation cases had increased in 2002. In this connection, for the period between 2003 and 2005, the reduction is observed in the number of CUs (from 349 CUs as of 01.01.2003 to 305 CUS as of 01.01.2005). Despite the reduction in the number of CUs, the increase is observed in the number of participants of CUs (from 25.2 thousand people as of 01.01.2003 to 27.7 thousand people as of 01.01.2005) that can be explained by the growth of popularity of CUs among the population and an improved understanding of the role of CUs in improving the social and economic standing of participants of CUs.

In July 2005, the Alliance of Associations of CUs has reached an agreement with the National Bank of the Kyrgyz Republic on the capital adequacy ratio about the possibility to set a less intensive schedule of institutional capital expansion.

There is continued discussion between CUs and the National Bank of the Kyrgyz Republic on the minimum requirements of the National Bank of the Kyrgyz Republic for obtaining a

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<sup>47</sup> The ratio of the maximum amount of external borrowings (H1) in 'Rules for Regulating Activities of Credit Unions in the Kyrgyz Republic', approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #14/2 of 4.05.2005. Registered by the Ministry of Justice of the Kyrgyz Republic #73-05 of 6.06.2005.

license to attract deposits in 5.1. of the Regulation ‘*On Licensing Credit Unions*’. The main issue of the discussion on the continued attraction of deposits is whether CUs should comply with all requirements during 12 months prior to obtaining a license in accordance with the requirement of the National Bank of the Kyrgyz Republic<sup>48</sup>, or full compliance should be required after obtaining a license. The principal point of the discussion is the issue of the period duration and CUs put a question to reduce this term. Moreover, the license for attracting deposits will be issued to CUs with adequate information systems, in such a case, the minimum requirements imposed on such systems should be determined by the National Bank of the Kyrgyz Republic.

Deposit mobilization activities are very limited in Kyrgyzstan<sup>49</sup>. In view of these facts, and given the positive results obtained in the course of implementing a pilot project, we may say that CUs represent organizations with the highest potential in terms of offering saving services, especially, in rural areas.

As of 01.01.2005, 305 CUs operated in the republic, out of them 244 CUs had debt to FCSDCU and 173 CUs had difficulties with the ratio of the maximum amount of external borrowings (that is, they could not increase the amount of external borrowings). However, 14 CUs out of 173 CUs complied with the minimum requirements of the National Bank of the Kyrgyz Republic for obtaining a license to attract deposits from participants of CUs.

Due to the transfer of supervision from the FCSDCU to the National Bank of the Kyrgyz Republic, and the review of the regulatory framework for CUs as of 01.07.2005, 30 CUs complied with the minimum requirements for obtaining a license from the National Bank of the Kyrgyz Republic to attract deposits from participants of CUs. Moreover, due to the review of the validity of design ratios for the maximum amount of external borrowings and the increase of the institutional capital amounts by CUs, the number of CUs that encounters problems with the ratio of external borrowings dramatically reduced and came to 93 CUs.

**Loan Loss Reserve:** The National Bank of the Kyrgyz Republic is revising the Regulation on Classification of Loans to bring the classification of loans and the establishment of loan loss reserves in line with the applicable norms for CBs.

**Improvement of the Law of the Kyrgyz Republic ‘On Credit Unions’:** It is essential to strengthen corporate principles, including the issues on the quorum of the general meeting of participants (Article 15), the responsibilities of the Credit Committee (Article 17), and the responsibility of the Board of a CU. CUs encounter problems of ensuring a 50 percent quorum required for decision making at the general meeting of participants. Proposals have been made to allow authorizing other participants of CUs to vote on behalf of members of CUs provided that the powers of attorney are duly executed. The Alliance of Associations of CUs established a working group to develop a new draft law on credit unions to solve these issues and to reduce the number of inconsistencies.

**Supervision of operations of CUs:** From July 1, 2005, the supervision of CUs had been transferred from FCSDCU to the National Bank of the Kyrgyz Republic. CUs have proposed

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<sup>48</sup> Regulation ‘*On Licensing Credit Unions*’ approved by the Resolution of the Board of the National Bank of the Kyrgyz Republic #14/3 of 04.05.2005. Registered by the Ministry of Justice of the Kyrgyz Republic #75-05 of 10.06.2005

<sup>49</sup> See further: Annex 2. Sectoral Analysis

to introduce a three-tier system in accordance with which small CUs that operate using their own funds shall not be supervised, and CUs with licenses to attract deposits will be prudentially supervised. The National Bank of the Kyrgyz Republic is considering various alternative options of the proposed tiered system. The new approach implies the participation of the Association of CUs that will institute an early warning system based on PEARLS that will enable to identify problems at early stages.

The underlying principle of focusing limited resources of the National Bank of the Kyrgyz Republic should be on CUs with good potential for savings mobilization. CUs should be classified according to the level of their development and rendered financial services.

## 2.4. Taxation Issues

The applicable Tax Code<sup>50</sup> was adopted in 1996. Since then so many amendments have been made that the Government of the Kyrgyz Republic decided to develop a complete new code to remove inconsistencies and to simplify it. In 2004 a Working Group on the Development of new version of the Tax Code of the Kyrgyz Republic was established with the objective to review and simplify the existing code. The Working Group comprised of the representatives of the Ministry of Economics and Finance of the Kyrgyz Republic, Jogorku Kenesh of the Kyrgyz Republic (the Parliament), the National Bank of the Kyrgyz Republic and the Chamber of Tax Consultants. On behalf of the financial sector, the National Bank of the Kyrgyz Republic has submitted for the Commission's consideration several taxation issues, part of which has been successfully solved by the new draft law. According to the Chamber of Tax Consultants there are still a number of flaws. It is expected that it will required several months to finalize the draft law after that it will be presented to the Parliament for approval.

According to international best practices the tax environment should be conducive for the development of market-based microfinance services for the poor, avoiding taxation anomalies and discrimination between types of providers<sup>51</sup>.

**Loan Loss Reserve:** According to Article 104 of the Tax Code of the Kyrgyz Republic, financial institutions licensed by the National Bank of the Kyrgyz Republic can deduct loan loss reserves from their taxable income. This article discriminates MCAs and MCCs operating on the basis of a certificate instead of a license. It has been agreed in principle to amend this article, and to include all financial institutions in the new draft code. The new rule will assumingly come into effect with the adoption of the Tax Code of the Kyrgyz Republic.

**Retail tax on consumption loans:** The tax on paid services to the population is a local tax that ranges between 2-4 percent depending on the oblast<sup>52</sup>. According to clarifications presented by the Ministry of Economics and Finance of the Kyrgyz Republic, this tax is collected from the amount of income on loans issued for personal consumption. The problem is that in order to prove the use of loan funds for economic purposes by borrowers, it is necessary to present the patents on engaging in entrepreneurial activities for the entire period of loan usage or a certificate of a private entrepreneur to tax inspectors that repel small

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<sup>50</sup> Tax Code of the Kyrgyz Republic, June 26, 1996

<sup>51</sup> Policy Change: A guide to analysis and advocacy, Women's World Banking, April 2004 and p.14 - Microfinance Consensus Guidelines – Core principles of microfinance regulation and supervision, 2003, CGAP.

<sup>52</sup> Tax Code of the Kyrgyz Republic - Article 195 - Tax on Retail Sales and Paid Services to the Population



entrepreneurs that pay high interests and have small income. It is proposed to exempt all income generated from credit arrangement services from the tax on paid services to the population in order to solve this issue.

**Operating costs in rural areas<sup>53</sup>:** Transportation costs of credit officers form a considerable part of operating costs in rural areas. As a rule, public transport owners do not provide proper receipts and financial institutions encounter difficulties of getting approval from tax authorities to include transportation costs in their operating costs prior to the computation of profit.

In those cases when employees receive transport allowances, such allowances are considered to be additional income therefore they are taxable. While these expenses can be partly included in the deductions to the social fund but it does not solve the problem. It is necessary to follow the principle that all reasonable business-related expenses should be deducted from income prior to the computation of profit. The Tax Code of the Kyrgyz Republic (Article 211 of the new version) should be amended to provide for expenses below a certain level that do not require confirming documentation especially for business operations in rural areas.

**Leasing<sup>54</sup>:** The Civil Code of the Kyrgyz Republic defines leasing as a form of property hire (rent) and addresses a general concept of lease management (for example, leasing agreements, leased assets, as well as rights and obligations of parties of the lease). Leasing is not licensed although licensed financial institutions should have an additional record in their license. Third party commercial arbitration can be used for the impressment of leased assets in case of breach of the contract, or if the impressment is challenged in the judicial procedure.

In accordance with the applicable Tax Code of the Kyrgyz Republic, the value added tax (hereinafter – VAT) is levied solely on the cost of leased assets, and not on interests to be paid, where the lessor's interest income is taxed at the rate of 10 percent. Problems remain with the streamlining of VAT. Currently it is beneficial for clients to obtain loans to acquire equipment then lease it. Consequently, the supply of leasing products is very limited.

## 2.5. Collateral Registration and Impressment

In March 2005 the new Law of the Kyrgyz Republic '*On Pledge*' was enacted governing all legal relationships related to the pledge. It was developed on the basis of two previously effective laws of the Kyrgyz Republic '*On Pledge*' and '*On Mortgage*'. The new law considerably improved and simplified an extrajudicial foreclosure procedure of the pledged property, including the provision on the possibility of transfer of the pledged property into the pledgee's ownership on the basis of the notary's executive endorsement. Nevertheless, a number of unresolved issues remain. In this context, on the initiative of the National Bank of the Kyrgyz Republic a working group was established to eliminate deficiencies in the Law of the Kyrgyz Republic '*On Pledge*'. The group comprises of the representatives from the Ministry of Justice of the Kyrgyz Republic, Central Pledge Registry and CBs. The group is working on solving procedural issues with the Ministry of Justice of the Kyrgyz Republic by adjusting instructions for notaries and registration offices, and on removing legal inconsistencies.

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<sup>53</sup> It has been emphasized that the problem is also affecting operations in urban areas.

<sup>54</sup> Leasing is governed on the basis of the second part of the Civil Code, adopted on January 1998 and the Law on Financial Rent (Leasing), adopted on July 2002.

The results of the questionnaire distributed by the National Bank of the Kyrgyz Republic among financial institutions at the beginning of 2005, and the discussions held with MFOs, CBs and CUs during three regional round tables conducted in July 2005 showed that despite all legal and procedural changes, there is room for further improvement of issues related to the pledge registration and foreclosure procedures.<sup>55</sup>

**Lack of information:** The existence of some problems can be partly explained by the lack of information, and slow implementation of new procedures and laws. Lawyers, regional public bodies and financial institutions are not always aware of new possibilities under the revised legislation. Consequently, financial institutions should regularly familiarize with revised procedures and (or) laws. A microfinance association that will be soon established, and existing associations of CUs should combine efforts to participate in working groups, access qualified legal assistance and share information on practices and procedures.

**Registration:** Registration procedures take a lot of time and are expensive because of the bureaucracy at notary offices and pledge registration offices. At the same time, it should be noted that the pledge registers have significantly streamlined their operations over the past years and offer special services for several large financial institutions. Furthermore, they are discussing with CBs the possibility to offer registration services in branches of CBs.

In order to reduce waiting and travel time, it has been proposed to locate notary offices and registration offices in one building and set similar working hours.

Currently only public notaries have the right to impose a ban for alienation of the pledge that can not be performed by private notary offices. Thus, there is a time gap between the notarial certification and the imposition of the ban that can be risky for the pledgee. In this context, it is recommended to develop the methodology of prompt transfer of information by private notaries to the public notary office on notarized pledge deals for the imposition of the ban in order to reduce the cost of notary services and to speed up execution timeframes.

Perhaps, procedures should be differentiated depending on the loan amount. For loans under 2000 dollars the required documentation, the notarial certification and other procedures could be simplified, and an adequate fee could be charged.

It is also possible to set simplified and faster procedures for repeat borrowers that will enable to extend the pledge registration without the need to cancel registration and re-registration.

**Mandatory certification:** A mandatory annual certification of the real estate appears to be unnecessary and further increasing the borrower's costs.

**Sanctions for selling movable pledge:** There is a problem related to the sale of movable assets pledged to financial institutions by clients, especially, in case of unregistered pledge. The Law of the Kyrgyz Republic '*On Pledge*' should be amended to include sanctions for the sale of pledged movable assets by the pledgor. The Ministry of Internal Affairs of the Kyrgyz Republic should ensure that the clients can not change the right of ownership on registered pledged vehicles.

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<sup>55</sup> Main contradictions relate to the Civil Code of the Kyrgyz Republic (Article 335 and other) and the Law of the Kyrgyz Republic '*On Agricultural Land Management*'.

**Lack of Insurance:** There is a need for greater number of insurance products to enable financial institutions to insure property and assets offered as a security.

**Collateral foreclosure:** The process of obtaining a court decision can take up to one year. In general, the practice shows that courts are often inclined to decide in favor of the borrower and not in favor of a lending institution. If the court case is won, the costs for the transfer of the ownership right are rather high at 1 percent of the loan amount.

**Sale of collateralized land:** Financial institutions encounter restrictions in selling the pledged agricultural land that have been repossessed from clients that failed to perform their loan obligations, in this case their standard price often exceeds the market value. In the context of a new Law of the Kyrgyz Republic ‘On Pledge’, it is necessary to streamline the Law of the Kyrgyz Republic ‘*On Agricultural Land Management*’ to include MFOs as the subjects of pledge legal relationships<sup>56</sup>.

**Information on pledged property:** Financial institutions can verify with the register on pledged or arrested property. Currently, the database includes information only by oblasts but in the future there may be established a national electronic database that grants access for registered users and enables to request information at the republican level. An alternative option is to request information through the Credit Bureau whose database includes information on the pledge. However, not all members of the Bureau comply with the requirement of presenting pledge data. Moreover, not all institutions are members of the Bureau.

## 2.6. Legislation for Credit Bureaus

A draft law on credit bureau is under development, and the discussion focuses on the extent of operations of credit bureaus that should be governed by the law. The existing draft law is considered to be rather restrictive as it limits operations of a credit bureau by the framework of a not-for-profit organization, disallows the inclusion of non-financial institutions, for example, providers of utilities, telephone companies and so forth. Furthermore, there are continued discussions whether the membership in a Credit Bureau should be voluntary or compulsory, whether their operations should be supervised or self-regulated. So far no agreement has been reached in terms of the volume of information that the Credit Bureau should present to the National Bank of the Kyrgyz Republic.

## 3. SUPERVISORY STRUCTURE

One Deputy Chairperson of the National Bank of the Kyrgyz Republic is directly subordinated to the Chairman of the National Bank of the Kyrgyz Republic and coordinates overall supervision activities of the National Bank of the Kyrgyz Republic comprising of 3 departments:

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<sup>56</sup> Article 23 of the Law of the Kyrgyz Republic ‘*On Agricultural Land Management*’



NBSD was organized in 1998 as a division and had been reorganized into a department from July 1, 2005. Its responsibilities include the registration and the supervision of all NFCIs (exchange offices, pawnshops, MFOs and specialized financial and credit institutions).

There are additional specialists for supervising CBs and NFCIs in regional departments of the National Bank of the Kyrgyz Republic that conduct on-site inspections and process financial information presented by NFCIs.

**Analysis:** NBSD staff is qualified and most staff members hold degree in economics and banking, also have on average over 6 years experience working at the National Bank of the Kyrgyz Republic. To date NBSD has been less involved in off-site supervision and on-site inspections since all microfinance organizations are registered as MCAs and MCCs that are not subject to supervision by this unit. FCSDCU and KAFC have been supervised in close collaboration with inspectors of the Bank Supervision Department. NBSD has been mainly engaged in the registration process, statistical processing and analysis of data received from MCAs and MCCs.

NBSD has received considerable training on supervision issues, and a great number of detailed training and procedural manuals have been developed. It is expected that the supervision of MFCs will be required during the forthcoming two years when some MCAs and MCCs will be transformed and receive licenses. It is necessary to promptly start supervising CUs, and the staff should be trained, and the system should be in place by the end of the year. Current supervision staff for NFCIs in the home office and regional offices is willing to exercise additional supervision of CUs. Employees seek to gain additional experience with on-site inspections. It is generally considered that the National Bank of the Kyrgyz Republic cannot supervise more than 300 CUs. It is essential to develop a supervisory system to enable the National Bank of the Kyrgyz Republic to focus its scarce resources on a limited group of large CUs, especially those that accept deposits from their members.

The analysis of inconsistencies given in the last chapter identified the need for changes in the normatives for CBs, CUs and in the future for MFCs. Kyrgyzstan is one of the few countries where CBs are greatly involved in microfinance. In December 2004, the share of the microfinance portfolio of banks participating in EBRD MSFF facility was on average 8 percent of the portfolio, and 33 percent of the clientele base, while the share per CB has increased to 20 percent. These developments result in new challenges as the supervision of microfinance activities should be different from the supervision of traditional banking activities because there are peculiarities in the applied methodology and risks involved. Furthermore, the introduction of the authorization for accepting deposits is another major challenge. The National Bank of the Kyrgyz Republic has rightly taken up a conservative position in light of recent bank crises in the country, and the challenges on how to gradually increase deposit mobilization through MFCs and CUs.

The importance of resolving supervision objectives is confirmed by the scale: 104 MFOs report twice a year and starting July 1, 2005 - over 300 CUs report by presenting their balance sheets, income statements, and portfolio data. The licensing and the processing of statistical information from all organizations is time consuming, while the share of most of them is not taken into account in the overall microfinance portfolio. The possibility should be considered to exempt organizations with only few clients from presenting statements twice a year. An important issue is how to deal with inactive MFOs (it is almost over 30 organizations), especially, with MCAs that are public organizations. In order to avoid the emergence of MFOs that are actually inactive in the market it is necessary to impose restrictions for their entry into the system, for example, by introducing minimum requirements.

## **ANNEX 4. MESO STRUCTURE**

### **(FINANCIAL SYSTEM INFRASTRUCTURE)**

Efficient institutions for retail sale of financial services to micro enterprises and poor segments of the population are the backbone of the financial system. “Donor guidelines on good practice in microfinance”<sup>57</sup> refer similar institutions to the micro level.

But retail institutions cannot operate in isolation. The new vision in micro finance recognizes the possibility to establish large-scale sustainable MFIs only if financial services for the poor are integrated into financial system comprising of three levels:

- the micro level (retail financial institutions and other providers);
- the meso level (financial system infrastructure);
- the macro level (policy environment).<sup>58</sup>

Such integration provides a greater access to the capital for institutions serving the poor, in a greater degree ensures the safety of the public savings, the legitimacy and professional standards of the sector. Integration into the financial system can, ultimately, open access to the majority of people, including the poor and those residing in more remote regions.

Success in building a financial system depends on the contributions of many actors and their ability to work together. In addition, the financial system for the poor segments of the population depends on the existing conditions, such as infrastructure, access to markets, production technology, and available information for risk mitigation.

### **Major characteristics of the infrastructure in the Kyrgyz Republic:**

#### **1. ASSOCIATION AND INTERACTION**

Microfinance associations, either at national or at regional level, are established by MFIs operating in similar markets.

Recently, larger MFOs are working on establishing a micro finance association that is expected to be registered by the end of 2005. Both commercial organizations and not-for-profit organizations will become members. CAMFA will provide initial financial support and information exchange.

For the past years CUs notably enhanced their collaboration. They are organized in several associations at national and regional levels. There is a regional association of CUs in each oblast. In addition, there are three national organizations. As an example, only one Association of Credit Unions and Cooperatives of Kyrgyzstan (hereinafter - ACUCK) unites 120 CUs. By the end of 2005 it is expected to unify all national associations of CUs into a

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<sup>57</sup> CGAP: Building inclusive financial systems: donor guidelines on good practice in microfinance. 2004.

<sup>58</sup> These Guidelines refer to the “financial system” as encompassing all three of these levels (micro, meso, and macro), where many of these actors are not exclusively dedicated to work in the financial sector (e.g., auditors, agro processors, technical service providers). The “financial sector” is defined more narrowly as including those actors directly involved in providing financial services or supervising financial institutions.

single Alliance of National Associations of Credit Unions that will represent a national coordinating body.

The interaction between MFOs is an important factor and can comprise of formal and informal contacts during trainings or meetings of the Association members. Exchange of information and best practices is especially essential for the prevailing number of MFOs that are small and have little experience. For them the exchange of experience and information is the cheapest and the effective way of improving knowledge.

The reality shows that one out of three MFOs does not interact with anyone. 42 percent out of those MFOs that contact on an ongoing basis see the main advantage in the exchange of experience. Such interaction is considered as a possibility to obtain short-term credit at a lower interest rate. 21.8 percent of respondents do not see any benefit in interaction of MFOs.

Half of the interviewed managers of MFOs do not see any benefits in interacting with banks and 18 percent of respondents find it difficult to answer this question. Perhaps, this shows that there is competition between MFOs and CBs. 27 percent of respondents consider that there is possibility to obtain loans in interacting with CBs. On the other hand, about 58 percent of respondents consider that they plan to attract commercial loans. Most of them have not established on what terms they agree to obtain loans. To the question what would be the maximum rate for a loan, 45 percent of respondents could not clearly indicate the rate and 29 percent simply indicated that the rate should be low. Only 16 percent of respondents are willing to pay 12 percent or more.

## **2. CREDIT BUREAU**

A credit bureau was established in 2003 with the support from the European Commission. By the middle of 2005 the database included information from 8 CBs (out of total 20 CBs) covering 75 percent of bank credits, and three MFOs: FINCA, Bai Tushum and Financial Group Kompanion. KAFC does not submit information yet.

Credit bureau information covers so far 40 percent of all outstanding loans. According to the business plan of the credit bureau, its financial sustainability should be achieved in 2006.

According to most MFIs, one of the factors hindering their entrance to the credit bureau is a high cost of entrance and annual membership fees. In this connection, the credit bureau is reviewing the fee issue presently.

In order to attract greater number of financial and credit institutions and to expand the information base of the credit bureau, it has been agreed to exempt CUs from the payment of entrance and annual fees.

Credit bureau services are available countrywide.

In order to improve the coverage of financial and credit institutions, it is essential to resolve problems with small financial institutions that lack computers and have no Internet access, and have little understanding of Internet advantages.

### **3. APEX INSTITUTIONS**

Apex institutions are institutions that provide wholesale resources (with/without supporting services) to retail institutions in the country or at the integrated market. The major institution of such type is FCSDCU.

This company was established as a wholesale organization for CUs with the support from ADB project. It extends loans to CUs and provides leasing services for their members. As of the beginning of 2005 its portfolio made up Som 240.4 million. Currently, the National Bank of the Kyrgyz Republic, ADB, FCSDCU and the representatives of the national associations of CUs are discussing the possibility of FCSDCU privatization and its transformation into an apex institution for CUs.

USAID/CAMFA established a specialized wholesale institution MCC '*Frontiers*' in 2003. The organization provides loans to CUs and MFOs, and finances organizations in the Kyrgyz Republic, Kazakhstan, Tajikistan and Uzbekistan. As of September 1, 2005, MCC '*Frontiers*' extended loans to 12 CUs and MFOs on the territory of Kyrgyzstan for the total amount of Som 32.8 million.

In February 2005 ACUCK established a Co-operative Stabilization Fund with the objective to finance CUs.

On a limited scale KAFC also provides whole sale loans to other financial and credit institutions. As of July 1, 2005 KAFC extended loans to 13 CUs and MCAs totaling to about Som 1.4 million.

### **4. BUSINESS DEVELOPMENT SERVICES<sup>59</sup>**

#### **4.1. Training needs**

Personnel of MFOs have small experience. A survey by NGO DCCA indicates that the average term of service for loan officers in MFOs is 2.9 years. It should be noted that young and experienced specialists work in the capital, and not in the regions of the country. There are often more females than males among loan officers (61.5 percent and 38.5 percent, accordingly).

The level of education among loan officers is high no less than 76 percent of them have higher education. 75 percent of them underwent microfinance trainings. For managers this level comes to 78 percent. Trainings are usually one-time seminars and training sessions conducted or initiated by donors under UNDP, EBRD, CAMFA and GTZ programs.

These short-term seminars are not sufficient to enhance the knowledge of the participants. CAMFA program has similar opinion, "short-term trainings seem not to be very effective"<sup>60</sup>. This shows the need for a more in depth training not at the seminars but on the job. EBRD

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<sup>59</sup> Business Development Services for MFOs include trainings, consultancy, the provision of the accounting software, audit services, marketing assistance, information, technology development and other services required for the operation and for the strengthening of organizations – See Business Development Services for Small Enterprises: Guidelines for Donor Intervention, 2001.

<sup>60</sup> Interview with Janice Stallard, CAMFA Program Director



MSSF is working in this direction: credit officers participate in intensive trainings of international specialists that concurrently work with them in CBs.

As for personnel of MFOs not working with donors, they practically do not receive information and professional knowledge since this market does not offer specialized training programs<sup>61</sup>.

In general, we may conclude that regular trainings are virtually not conducted by training centers and consultants. In this context as a positive example, we can cite the distance-learning training program for '*Junior Banking Manager*' specialization developed in 2003 by GTZ and implemented in two professional lyceums in Bishkek and Osh. This program is for 1-2 years. A certificate or a diploma is given upon completion of the training program. Guest instructors train practitioners from the microfinance sector. The Microfinance Center in Almaty provides short-term courses for Central Asian countries and also expects to increase the number of seminars for Kyrgyz microfinance sector.

Managers and personnel of MFOs recognize the importance of further training: 84 percent of respondents indicated the need in specialized training. This conception has been confirmed during the regional round tables that proves the need in trainings. In most cases, this need does not necessarily translate into effective real demand as most MFOs have no funds for training loan officers.

## **4.2. Consultancy**

The regional round tables revealed the need to support management information systems, accounting software and lending methodologies in order to improve the efficiency of MFIs.

MFIs consider that the access to such services is very limited. Few companies such as: Expert, Training and Consultancy Centre and DCCA offer specialized consultancy services. Many senior consultants and experts are full-time contracted by government and donor projects, and can offer consultancy services that are limited in scope.

At the same time, the demand for consultancy services is also poorly developed partly due to the lack of a tradition contracting external services, and partly because these services are expensive.

## **4.3. Audit Services**

In the Kyrgyz Republic there is lack of knowledge of effective financial management, accounting, auditing, and financial statements<sup>62</sup>. The level of the accounting support is insufficient, and auditors often seem to be inexperienced. Many accountants have received limited training during the conversion from the Soviet system of accounting to the Kyrgyz Accounting Standards that were adopted in 1998. The EU-TACIS survey under the accounting project demonstrated that approximately 90 percent of analyzed enterprises did not use any accounting software. Many MFIs expressed an opinion that audit services are

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<sup>61</sup> NGO '*Development and Cooperation in Central Asia*': The Status of the Micro finance Sector in the Kyrgyz Republic, p. 13.

<sup>62</sup> Based on the discussion with the sector, including Ms. Barbara Simmonds under the EU-TACIS funded project '*Creation of favourable conditions for reforming the management system of enterprises through the introduction of IFRS*'

expensive. The development strategy of the system of CUs provides for the establishment of own internal cooperative audit function.

#### **4.4. Information technologies and management information systems**

Most MFOs and CUs use Excel program or manual systems for administering their loan portfolios. Several large MFIs use existing software such as Loan Performer, Tremens Emerge, or have developed their own software. With the GTZ support the Microbanker software has been upgraded and introduced in a number of CUs. There are discussions in progress on the possibility to standardize Microbanker software for the entire sector of CUs. Several companies and individuals offer computer equipment and licensed software in the area of office management, accounting and databases. However, the sector of information technologies is concentrated only in Bishkek and in oblast centers. Also most small MFIs are not aware of the importance to computerize their credit administration.

Internet infrastructure is rapidly expanding and is now available in all cities. However, there is limited awareness of Internet capabilities.

## ANNEX<sup>63</sup> 5. TECHNICAL ASSISTANCE OVERVIEW

Donors played a very important role in the development of the micro finance sector in the Kyrgyz Republic. For the past ten years, they invested, in the form of grants for institutional support and equity, as well as through loans, approximately US\$ 86 million (the equivalent in som as of January 1, 2005 is Som 3 526 million).

**Table 1. Estimated donor support for the period 1996 - 2005**

Organization	Credit Lines	Grants and Equity Investments
ADB	17 500 000	500 000
MSFF with the support: EBRD, TACIS, SECO <sup>64</sup> , International Financial Corporation	15 000 000	
Department for International Development of the United Kingdom		120 000
EU-TACIS		900 000
GTZ		3 500 000
International Financial Corporation	1 200 000	1 050 000
'Soros Foundation-Kyrgyzstan'		747 000
USAID		12 400 000
World Bank	32 400 000	1 000 000
Total:	66 100 000	20 217 000

Source: interview with donor organizations and information from Internet web-sites

In planning the support for the microfinance sector in the future, the donors will be guided by the principles as defined by CGAP<sup>65</sup> and direct their resources to the following:

- Help financial institutions in reaching large number of poor people as the lack of strong retail financial intermediaries remain the major bottleneck to expanding financial services;
- Build local capacity and markets (for example, local providers of capital and technical services): at macro, meso and micro levels as the success will ultimately depend on the level of professionalism of local managers and institutions, and not donors.
- Disseminate analytical materials on the financial system to avoid reinventing the wheel;
- Support private sector initiatives;
- Harmonize standards and procedures to increase efficiency of all types of donor engagements;

<sup>63</sup> This annex includes information obtained during working meetings held within the Strategy development framework with the representatives of international donor organizations implementing their operations in the Kyrgyz Republic.

<sup>64</sup> Swiss Secretariat for Economic Development

<sup>65</sup> Building inclusive financial systems: Donor Guidelines on Good Practice in Microfinance, December 2004.

- Use subsidies to make financial markets work for poor people, not undermine them. Every financial service project design needs to outline how the donor subsidy complements or stimulates private capital.

## ASIAN DEVELOPMENT BANK

In 1997 ADB approved a concessional<sup>66</sup> loan to the Kyrgyz Republic for the amount of SDR 9005 million that presently corresponds to about US\$ 12.5 million (as of January 1, 2005 the equivalent in som (hereinafter – the equivalent in som) – Som 512.5 million) for the development of CUs, ‘*Rural Financial Institutions*’ project. The credit line amount has been revised twice and as of current date makes up US\$ 10 million (the equivalent in som – Som 410 million) (about US\$ 2.5 million was annulled (SDR 1701.5 thousand or the equivalent in som - Som 102.5 million) for consulting services). The technical assistance component was taken over by GTZ and funded by Government of Germany on a grant basis. From the dedicated credit line amounting to about US\$10 million (the equivalent in som – Som 410 million), ADB disbursed US\$7.5 million (the equivalent in som – Som 307.5 million). Within the framework of the project, FCDSCU was established in April 1997 to develop, regulate and supervise operations of CUs, and to on-lend the credit line. At the beginning of 2005 over 300 CUs have been established with the aggregate loan portfolio amounting to over Som 410 million. The project was extended for 1 year and the expected project closing date is the end of 2005. FCDSCU will repay funds starting 2006 for 13years<sup>67</sup>.

In 1998 ADB provided a loan to the Kyrgyz Republic for about US\$36 million (the equivalent in som – Som 1476 million) for the development of agriculture in Chui Oblast<sup>68</sup>. The loan includes a US\$10 million credit line (the equivalent in som – Som 410 million) for on-lending to farmers and agribusinesses through KAFC.

Over the period 2003–2005 ADB provided technical assistance amounting to about US\$500 thousand (the equivalent in som – Som 20.5 million) aimed at improving the capacity of the NBSD and strengthening the capacity of CUs and MFOs. It included advisory services and assistance of three technical consultants in the development of off-site and on-site inspection manuals, on-the-job trainings, development of normatives for MFOs and CUs. One more expert is scheduled to provide additional training to employees of NBSD of the National Bank of the Kyrgyz Republic at the end of 2005.

**Future plans:** the planning of the next cycle of the ADB work in the Kyrgyz Republic will be coordinated with other donors, including the Department for International Development of the United Kingdom and the World Bank. A joint program development activity will be conducted after which each donor will choose the components on which the assistance will be rendered.

## DEPARTMENT FOR INTERNATIONAL DEVELOPMENT OF THE UNITED KINGDOM

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<sup>66</sup> 40 years with 10 years grace period and the interest rate of 1 percent.

<sup>67</sup> The interest rate makes up approximately 6.5 percent per annum.

<sup>68</sup> Concessional loan: the term is 32 years, the grace period is 8 years, and the interest rate is 1 percent.

Starting 2002 the Department for International Development of the United Kingdom implements a project aimed to develop income-generating activities in livestock producing households. Its total budget is US\$3 million (the equivalent in som – Som 123 million). It includes a credit fund amounting to US\$120 thousand (the equivalent in som – Som 4.9 million) for on-lending to rural groups formed under the project through KAFC. As of end of 2004, over Som 2 million has been on-lent to livestock and other households at the rate of 15 percent per annum.

**Future plans:** Department for International Development of the United Kingdom has no plans to support the microfinance sector of Kyrgyzstan.

### **EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

EBRD started implementing the Micro and Small Enterprise Finance Facility in 2002 within the framework of the Central Asian project jointly funded by USAID, TACIS, International Financial Corporation and SECO. Currently a credit line of US\$15 million (the equivalent in som – Som 615 million) is available for five participating CBs in Kyrgyzstan: JSCB ‘Kyrgyzstan’, ‘Energo Bank’, ‘Halyk Bank’, ‘Kazkommertsbank’ and ‘Inexim Bank’.

Within the framework of this program the German company IPC GmbH funded by TACIS and USAID provides intensive technical assistance to the banks. Currently, 293 credit officers use a specialized individual lending methodology based on cash flow analysis and solvency evaluation given the limited requirements to the pledge. As of June 2005, total of 44 lending outlets (small and micro loan units) operated in the named CBs in Chui, Issyk-Kul, Jalalabad and Osh oblasts with the total outstanding loan portfolio of Som 697 million (US\$ 17 million).

**Future plans:** A decision has been made to open an additional credit line of US\$ 30 million (the equivalent in som – Som 1 230 million) to enable the program expansion. The pilot projects are being implemented on the introduction of agricultural lending and CBs gradually expand their network of lending outlets in the rural areas. In addition, EBRD supports MFOs. A loan to MCA ‘Bai Tushum’ had been approved. Furthermore, it is planned to conduct a due diligence to evaluate the performance of MCC ‘Financial Group Kompanion’ jointly with an American Bank Shorecap.

### **EUROPEAN UNION - TACIS**

Besides the co-financing of the EBRD MSFF, the EU-TACIS program has supported a number of initiatives in the micro finance sector.

Within the framework of the regional development of Issyk-Kul project (with the total budget of US\$ 2 million (the equivalent in som – Som 82 million) the organizations extending micro credits, and loans for small and medium size businesses have been explored, the brochures have been published to inform small enterprises on the funding possibility and trainings have been conducted for financial institutions, including CBs, MFOs and CUs. The project will end in 2005.

Support to the Non-Banking Sector project with the total budget of US\$1.2 million (the equivalent in som – Som 49.2 million) provides assistance to the Ministry of Economics and

Finance of the Kyrgyz Republic in promoting an environment conducive to the development of new non-banking financial services, including pension funds and insurance market.

Several financial institutions received direct support. In 2003 KAFC received technical assistance in the amount of US\$900 thousand (the equivalent in som – Som 36.9 million) aimed at improving its operations and lending methodologies. In the same year, MCA ‘Bai Tushum’ obtained a grant to develop mortgage lending for small and medium size entrepreneurs.

**Future plans:** EU-TACIS has no plans to support the microfinance sector of Kyrgyzstan.

### GERMAN DEVELOPMENT COOPERATION AGENCY

In 1999 GTZ started implementing the ‘*Financial System Development in Rural Areas*’ program to provide assistance to CUs in executing the ADB program. The project with a total budget of USD\$3.5 million (the equivalent in som – Som 143.5 million) helped to build the system at three levels: national associations, regional associations and credit unions, including:

- Assistance to FCSDCU in the development of the supervisory function and in the restructuring, and the assistance to the National Bank of the Kyrgyz Republic in developing normatives for CUs and the assumption of the supervision function starting 2005;
- Development of an early warning system based on PEARLS that should be used by regional associations;
- Implementation of over 100 trainings for 3000 members of CUs and the development of several standardized manuals on lending, accounting, deposit mobilization;
- Establishment of a distance learning program ‘Junior Banking Manager’ in two lyceums in Osh and Bishkek;
- Implementation of a pilot project on the introduction/implementation of FAO Micro banker software in 10 CUs, and the adjustment of the software.

**Future plans:** The movement of CUs will need technical assistance program for another few years before it can function independently. The GTZ program is ending in 2005, however, the national staff will continue implementing pending activities during 2006. GTZ involvement in future programs will depend on the outcome of bilateral negotiations on the bilateral assistance for the subsequent years on the part of Germany.

### INTERNATIONAL FINANCIAL CORPORATION

Strategic objectives of the International Financial Corporation in Kyrgyzstan involve the financial sector development. For the past years the following activities related to microfinance have been supported:

- In 2002 a grant amounting to US\$ 50 thousand (the equivalent in som – Som 2.1 million) was provided for developing a law and normative acts on the regulation of MFOs;
- FINCA received US\$1 million (the equivalent in som – Som 41.0 million) to support its lending operations for the period of its transformation from a not-for-profit MFO into a commercial MCC. In addition, technical assistance was provided to assist

FINCA to transform its organizational structure and to develop a long-term strategy of a MCC.

- With joint funding from SECO and USAID, International Financial Corporation implemented a regional leasing project. The project promoted leasing products, conducted trainings and supported the development of the appropriate legislation in the Kyrgyz Republic. In developing the Law of the Kyrgyz Republic ‘*On Leasing*’ the project worked closely with the Government of the Kyrgyz Republic. Trainings had been conducted for companies willing to start leasing operations, and for small and medium size businesses willing to use new financial instruments. The project was completed in 2004, and a consultancy company was appointed to continue activities;
- International Financial Corporation is conducting a regional housing finance survey in Central Asia with the support from SECO. The research project started in Kyrgyzstan in the middle of 2005. The survey will serve as a basis for future plans to reduce the cost and improve the availability of funds for acquiring housing by households with low and average level of income, and where it is feasible, for the development of business plans for companies under primary and secondary mortgage finance;
- International Financial Corporation participates in the co-funding of the EBRD MSFF.

**Future plans:** International Financial Corporation considers the possibility of financing two microfinance organizations that should be transformed into deposit taking MFCs.

### INTERNATIONAL MONETARY FUND

Technical assistance is a key aspect aimed at strengthening the banking system and enhancing the country’s debt monitoring function. IMF also actively supports the capacity building of the personnel of the National Bank of the Kyrgyz Republic through the funding of training courses. In July 2005, training has been conducted on early warning system for the employees of non-bank supervision and bank supervision departments of the National Bank of the Kyrgyz Republic.

### SOROS FOUNDATION-KYRGYZSTAN

For the period 2003-2005 the scope of assistance rendered by the ‘Soros Foundation-Kyrgyzstan’ amounted to about US\$ 747 thousand (the equivalent in soms – Som 30.6 million) and consisted of three components:

- Support to CUs through provision of trainings on credit and deposit operations, accounting, internal audit, control and crisis management. Office equipment was provided to 25 CUs. The budget amounted to US\$ 544 thousand (the equivalent in som – Som 22.3 million);
- Establishment of an information resource center<sup>69</sup> on leasing and provision of 20 trainings on leasing, including the production of textbooks. Furthermore, a report on the leasing sector in Kyrgyzstan was published, and the support was provided in preparing amendments to the Tax Code of the Kyrgyz Republic related to the leasing. The budget made up about US\$178 thousand (the equivalent in som – Som 7.3 million);

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<sup>69</sup> [www.leasing.to.kg](http://www.leasing.to.kg)

- Provision of a grant to two MCAs amounting to \$25 thousand (the equivalent in som – Som 1 million) to expand their individual lending operations.

**Future plans:** The foundation will soon approve its strategy for future support to the sector. Four MCAs active in small towns will receive grants to increase their loan portfolios. Institutional capacity of MCAs will be strengthened through the provision of trainings and consulting services within the total budget of US\$100 thousand (the equivalent in som – Som 4.1 million). Other activities can be determined on the basis of the action plan for the new microfinance strategy.

## **SWISS SECRETARIAT FOR ECONOMIC DEVELOPMENT**

Within the framework of the assistance to the private sector development, the Swiss Government supported several projects. Apart from the co-financing of the EBRD MSFF, the Swiss Government supported two more projects in the micro finance sector:

1. In cooperation with ACDI/VOCA, since 2000 SECO (through the Swiss NGO Caritas) participated in the capacity building of MCA ‘Bai Tushum’, one of the leading MFIs with the loan portfolio of US\$4.5 million (the equivalent in som – Som 184.5 million). At present, after completion of the Swiss technical assistance, SECO has a representative on cooperation in the Supervisory Board of MCA ‘Bai Tushum’.
2. MCC ‘Titus Central Asia’ was established within the framework of “Small Sectors and Business Development” project to extend credits to project beneficiaries. The program was co-financed by the Swiss organization BPN/Servius (credits and implementation), and SECO (technical assistance for the period of 1999-2006 with a budget of US\$2 million (the equivalent in som – Som 82 million) with the objective to improve the qualification of entrepreneurs, train them in modern methods of business conduct and, at the same time, provide them with access to funding for business development.

**Future plans:** The Swiss Government will continue its support to the microfinance sector within the framework of existing projects. There are no plans for additional support to the microfinance sector in the future.

## **UNITED NATIONS DEVELOPMENT PROGRAM**

UNDP Poverty Reduction Program over the period of its implementation from 1998-2004 with the total budget of US\$3.1 million (the equivalent in som – Som 127.1 million) was focused on the social mobilization of rural communities and provision of access for the poorest rural population to the microfinance. The program operated in seven oblasts covering 140 target villages as a whole.

Target villages have been identified jointly with KAFC, Rural Advisory Services and local self-governance authorities based on the principle of maximum vulnerability, high poverty level, lack of social infrastructure and remoteness. By the end of 2004, 1256 SHGs were established, and the total number of participating members came to 8266 people, at the same time more than 12000 people had been trained. Over the program implementation period, internal group savings have been mobilized totaling to US\$ 200 thousand (the equivalent in som – Som 8.2 million), and 3370 collateral free loans were extended through KAFC amounting to about US\$5.5 million (the equivalent in som – Som 225.5 million) on the



whole. 26 of the most mature Associations of SHGs completed an intensive capacity building program, and then on a competitive basis, 10 Associations received small seed capital grants to establish MCAs. These MCAs continue receiving wholesale collateral free loans from KAFC at the rate of 13-18 percent per annum.

**Future plans:** Currently UNDP is entering a New Program Cycle for the period 2005-2010. Within the framework of the new UNDP Poverty Reduction Program with the total budget of US\$4.5 million (the equivalent in som – Som 184.5 million), among other components, further assistance will be provided for the development of the microfinance sector. The possibilities will be explored to expand financial services, such as micro leasing, micro insurance and so forth.

## **UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)**

Over the past years USAID provided substantial assistance to the microfinance sector of Kyrgyzstan:

- FINCA received US\$6.2 million (the equivalent in som – Som 254.2 million) for the loan portfolio and technical assistance. In addition, MCA ‘Bai Tushum’ received a grant totaling to about US\$1 million (the equivalent in som – Som 41.0 million) to finance technical assistance received from ACDI-VOCA and to purchase management information system;
- In 2002 CAMFA was established to provide technical and consulting services to MFOs in Central Asia (Kazakhstan, Uzbekistan, Tajikistan and Kyrgyzstan). The budget for Kyrgyzstan amounted to US\$3.1 million (the equivalent in som – Som 127.1 million). Equipment, training and technical assistance has been provided to several organizations, including MCAs supported by the Mercy Corps. Currently, the program is working with three CUs. In addition, CAMFA financed technical assistance for the transformation of FINCA into a joint stock company, and the follow-up transformation into a deposit-taking MFC. In 2003 MCC ‘FRONTIERS’ was established and capitalized to provide wholesale loans to MFOs in four republics. CAMFA program is expected to complete its activities in September 2006;
- In 2004 jointly with International Financial Corporation, USAID financed 4 training programs for the employees of the National Bank of the Kyrgyz Republic on supervision and regulation of MFOs. Starting 2005 and over the past two years, a foreign advisor is directly working with the Bank Supervision Department of the National Bank of the Kyrgyz Republic by assisting in training employees of the National Bank of the Kyrgyz Republic on the issues of on-site and off-site supervision of CBs;
- US\$ 2.1 million (the equivalent in som – Som 86.1 million) was appropriated to the EBRD MSFF to train loan officers, provide technical equipment and technical assistance in developing new rural finance related products.
- MCAs operating under Mercy Corps micro credit program and MCA ‘Bai Tushum’ were capitalized from the proceeds of the Monetization Program of the United States Department of Agriculture.

**Future Plans:** USAID has not defined its future assistance in microfinance area. There is intention to continue support in agricultural lending within the framework of the EBRD

MSFF program. USAID will consider the possibility to establish guarantee facilities under the 'Loan for Development' program.

## WORLD BANK

World Bank is the main donor in the microfinance sector of Kyrgyzstan:

- within the framework of *Private Enterprise Support Project*, a credit line of US\$13.5<sup>70</sup> million (the equivalent in som – Som 553.5 million) was launched for such CBs as JSCB 'Kyrgyzstan', OJSC 'Dos-Credobank', CJSC 'Ineximbank' and OJSC 'Energobank' to provide long-term enterprise finance. CBs received technical assistance for capacity building. The project was completed in 2003;
- Under the '*Rural Finance I and II*' projects two credit lines totaling to US\$31 million<sup>71</sup> (the equivalent in som – Som 1271 million) were launched for KAFC to finance individual loans and solidarity groups of low-income farmers. The Rural Finance Program started in 1996 and will be completed at the end of 2005. The credit line should be repaid within the next 20 years;
- Within the framework of '*Agricultural Support Service Program*', IFAD financed KAFC to on-lend SHGs formed by the UNDP, and within the framework of other projects;
- Under '*Payment and Banking Systems Modernization*' project, the national payment system of Kyrgyzstan is being modernized to enable wider use of automated teller machines and point-of-sale terminals in shops. The program intends to focus its activities on the areas outside Bishkek. The second component of the project focuses on the improvement of SSC's operations. SSC will expand its customer base through modernization and product diversification: savings deposits of the public, collection of taxes, payments for utilities, payments of pensions and salaries, installation of automated teller machines and issuance of credit cards. The issue of improving SSC's physical outreach can include the survey of the possibility to partner with the postal system of Kyrgyzstan using some post office windows for the delivery of payment services that will enable to increase the outreach to the rural regions. However, this process is at an early stage and no activities have been yet implemented;
- The main objective of the 'Village Investment' project is to assist in rural poverty reduction. Agency on Community Development and Investments was funded by two NGOs and the Government under the program in the amount of US\$15 million (the equivalent in som – Som 615 million) Within the framework of the program component for the support of the group of private small enterprises, US\$1 million (the equivalent in som – Som 41 million) was appropriated for microfinance initiatives.

**Future plans:** The WB is increasing the provision of assistance through grant financing. Current plans for the financial sector include the following:

- The WB is discussing with the Government of the Kyrgyz Republic the issues related to development of mortgage/housing lending in Kyrgyzstan. The Housing Finance Project that has been recently launched by the International Financial Corporation should explore the peculiarities and give ideas for future cooperation;

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<sup>70</sup> Terms: 35 years with a grace period of 10 years. Annual interest rate is 0.75 percent.

<sup>71</sup> Terms: the first loan of US\$16 million for 15 years with a 5 year grace period and a floating interest rate equal to the inflation rate. The second loan US\$15 million for 15 years with a 3 year grace period.

- '*Agribusiness and Marketing*' project has been approved and is expected to start at the end of 2005. The '*access to credit*' component includes a credit line of US\$6 million (the equivalent in som – Som 246 million) for participating banks<sup>72</sup>. There is an additional budget of US\$ 680 thousand (the equivalent in som – Som 27.9 million) for technical assistance in training employees of participating CBs, including KAFC. Trainings will be conducted on the issues of risk mitigation instruments in agricultural lending, including transaction finance, for example, the system of warehouse receipts and other funding mechanisms based on consumer commodities. The maximum loan amount is US\$200 thousand (the equivalent in som – Som 8.2 million). Although, main activities under the credit line will be conducted with medium enterprises and smaller individual farm enterprises;
- Individual groups or groups organized in cooperatives will be also able to benefit from the implementation of this program.

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<sup>72</sup> Terms: 15 years, including a 3 year grace period, and dollar LIBOR that is currently about 3.3 percent per annum.