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# Reforming Uzbek Banking System

## Uzbekistan government adopted a five-year strategy (2020-2025) to develop its banking system

*The strategy aims to reform the banking system as a whole with particular focus on reducing state involvement in the banking sector.*

*The key part of the reform concerns the privatisation of 6 major banks with the support of IFIs (IFC, EBRD, and ADB): **Ipoteka Bank, Uzsanoatqurilishbank, Asaka, Aloqabank, Qishloq Qurilish Bank, Turonbank** (sale is set to take place in 2022-2023)**.** The state will also sell its shares in **Halq Bank** and **Asia Alliance Bank** (in 2020 - 2021). The Project Office of the Ministry of Finance will be the state party authorised to carry out the transformation, privatisation and the sale of state shares.*

*The state shares in the **National Bank for Foreign Economic Activity**, **Agrobank**, and **Microcreditbank** will be retained. These banks will be subjected to a transformation.*

*Important action points proposed to restructure the banking sector include a ban for banks to engage in non-core businesses, an increase of the minimum charter capital amount to USD 50m.*

*This note also touches on other key action points to be implemented for the reform of the banking system (e.g. increasing the role of non-bank institutions) and the target figures expected to be achieved by 2025.*

On 12 May, the President of the Republic of Uzbekistan signed a Decree "On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025". The document defined the conceptual framework, principles, and directions of the transformation of the banking system for the next five years and approved the corresponding Strategy and Roadmap for its implementation.

The Presidential Decree outlines four main areas of focus for the reforms in the Uzbekistan banking system:

**(1)** Improving the effectiveness of the banking system;

**(2)** Ensuring the financial stability of the banking industry;

**(3)** Reducing state involvement in the banking sector; and

**(4)** Increasing the accessibility and quality of financial services.

Below is a summary of some of the key action points from the Roadmap for reforming the banking system in the Uzbekistan in the period of 2020-2025:

### Privatisation

> *Today, the state has a dominant position in the banking sector – 13 out of 31 banks have a state share in their capital. The capital of these banks is equal to more than 87% of the cumulative capital of the banks in the republic, whereas, assets amount for more than 85% of the total assets of the banking system. The state plans to change the current trend and gradually sell its shares in 6 banks.*

The privatisation of the banking sector will be carried out in two stages: the banks will have to undergo a transformation and modernisation process before the state shares are put up for sale. Key action points under the privatisation plan include the following:

**Transformation and privatisation of 4 Uzbek banks with the assistance of IFIs**

The first group of banks to undergo the two-staged privatisation process will be Ipoteka Bank, Asaka Bank, Uzsanoatqurilish Bank (UzPSB), and Aloqa Bank.

The international financial institutions (IFIs) will assist banks with the transformation and privatisation process: Ipoteka Bank and UzPSB will be assisted by the IFC, Asaka Bank by the EBRD, and Aloqa Bank by both the EBRD and the ADB. We note that UzPSB, Ipoteka Bank and Asaka Bank, respectively, represent the second, third and fourth largest banks in Uzbekistan.

**Sale of state shares in Halq Bank and Asia Alliance Bank**

Halq Bank and Asia Alliance Bank (AAB) will first undergo the 'fit and proper' approval process of the Central Bank before the sale of state shares to investors.

We note that Halq Bank used to be a national savings bank and until recently was the exclusive provider of pensions. AAB, in turn, was nationalised in late 2018 and early 2019 when the private owner had to sell their ownership in the bank to the state due to unpaid debt owed to the state. AAB previously the subject of acquisition talks with Japanese investors.

**Merger of QQB and Turon Bank**

Qishlok Qurilish Bank (QQB) and Turon Bank will also undergo a transformation, following which the Government will consider whether to merge these two banks before the potential privatisation.

**National Bank for Foreign Economic Activity, Agrobank and Mikrokreditbank**

The state is going to retain ownership of these three banks. The National Bank for Foreign Economic Activity (NBU) is qualified as a systematically significant bank, which will mainly service strategic enterprises and investment projects (through a project factory approach) on a market basis. The other two banks are to remain with the state to serve as vehicles of state support for businesses and to ensure access to banking services remains in provinces, since both banks have a wide territorial network throughout the country.

## Restructuring the banking sector

Some of the key action points for restructuring the banking sector include the following:

**Transformation of three banks (NBU, Agrobank, Mikrokreditbank)**

The transformation process generally is expected to cover four areas: (1) corporate governance improvements; (2) improvement of the quality and variety of banking services; (3) implementation of modern information technologiesl and (4) increasing potential of bank staff.

**Reorganisation of UzAgroExport Bank and Poytaht Bank**

These banks, which were established in the last 4 years, will undergo a reorganisation. It is not yet clear what form the reorganisation will take: whether they will be merged, liquidated or otherwise. The decision to reorganise these banks will be made by September 2020.

**Freeing up banks from non-core businesses**

Banks will be gradually released from non-core functions, including assistance to homeowners' associations, functioning as a tax agent, etc. Banks will be required to sell off any non-core assets. As per the recently adopted Law on Banks and Banking Activities (new edition), we note that banks are already prohibited in owning non-core businesses, with certain exceptions (e.g. banks are allowed to own related businesses such as leasing, insurance companies).

**Increasing the minimum charter capital to USD 50m**

As one of the measures aimed at ensuring financial stability of banks, the minimum charter capital of banks will be increased to UZS 500bn (circa USD 50m). Currently, the minimum charter capital requirement for banks is UZS 10bn (circa USD 10m).

## Improvement of legal landscape

There are four key areas where the legal framework will be subject to enhancement:

1) Introducing a legal basis for new business models for non-bank financing. The appropriate legal framework will be created for the work of FINTECH companies and retail lending entities. The authorities will also consider introducing direct lending to individuals, crowdfunding, and other alternative instruments.

2) Legal regulation of bank recovery. The relevant law on recovery of banks is planned to be drafted with the assistance of the World Bank and the experts from IFIs by September 2021.

3) Simplification of laws on bank operations in the securities markets. It is aimed that as a result of the reform, it will be easier for banks to issue and place bonds and other instruments. As part of this measure, it is also anticipated that a regulatory framework for tapping into international bond markets will be developed.

4) Legal bases for the development of non-bank credit institutions. Experts from the World Bank as well national experts will participate in drafting of the law on non-bank credit institutions.

## Other reform policies and action points

Other notable action plans include:

- The role of **non-bank credit finance institutions** will increase: these include institutions like the State fund for the support of entrepreneurial activities, the Fund for Reconstruction and Development of Uzbekistan (UFRD) and non-bank credit institutions (e.g. microcredit institutions). We note that starting from last year, the UFRD is now able to finance big investment projects in the country directly (without utilising an on-lending structure it relied on for years).

- Improving the regulatory and monitoring mechanism of the **Central Bank**, including control and management based on a risk management method (risk-oriented control).

- The **Ministry of Finance** will be responsible for the transformation of state-owned banks and implementation of modern corporate governance measures. The Project Office for the Transformation and Privatisation of State-Owned Banks will be set up within the Ministry. The Ministry will perform the duties of shareholder on behalf of the state while these processes are introduced.

- State-owned banks will implement the **OECD standards on corporate governance**. Some of the new standards include setting up professional supervisory boards with transparent nomination procedures, information disclosure policies, interaction with state supervisory authorities.

- Measures to reduce the level of **dollarization** will be taken with respect to the structure of assets and liabilities of banks. As part of these measures, it is expected that certain types of foreign currency loans will be restricted. Besides this, measures will be taken to reduce the share of foreign currency in banks' assets and liabilities.

- Implementing a suite of **IT and technological advancement measures**: inviting leading IT companies to offer products meeting international standards; creation of a highly qualified group of underwriters, development of a scoring system; automation of a crediting system by introducing modern systems of borrower identification; introduction of automatic data-handling systems on the basis of Big Data and RegTech and SupTech solutions, for the optimisation and automation of administrative and operational procedures in banks.

## Target figures to be achieved by 2025

The key targets to be achieved by 2025 as part of the strategy include:

- Increasing the share of bank assets that have no state participation from the current 15% to 60% in the total volume for the sector;
- Increasing the share of bank liabilities before the private sector from 28% to 70% against the total amount of liabilities;
- Increasing the share of non-banking credit organisations in the total volume of lending in the market from the current 0.35% to 4%;
- Attracting at least three foreign strategic investors with appropriate experience, knowledge, and reputation to at least three state-owned banks.

We are proud to state that our firm is actively involved in the reform of the banking sector of the Republic of Uzbekistan. We are currently advising the IFIs on the transformation and further privatisation of two major state-owned banks.

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