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Report No: PAD4468

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED CREDIT

IN THE AMOUNT OF US$15 MILLION

TO THE

REPUBLIC OF UZBEKISTAN

FOR A

UZBEKISTAN FINANCIAL SECTOR REFORM PROJECT

May 3, 2022

Finance, Competitiveness And Innovation Global Practice
Europe And Central Asia Region

CURRENCY EQUIVALENTS

Exchange Rate Effective March 31, 2022

Currency Unit =	UZS
UZS 11,400 =	US$1
US$ =	SDR 1

FISCAL YEAR
January 1 - December 31

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ABBREVIATIONS AND ACRONYMS

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism	IFR	Interim Un-audited Financial Reports
ADB	Asian Development Bank	IMDA	Insurance Market Development Agency
AQR	Asset Quality Review	IMF	International Monetary Fund
CBU	Central Bank of Uzbekistan	IPF	Investment Project Financing
CEM	Country Economic Memorandum	ISR	Implementation Support and Results Report
CPIA	Country Policy and Institutional Assessment	IT	Information Technology
CPF	Country Partnership Framework	KPI	Key performance indicator
CTLC	Component and Technical Lead Coordinators	MCO	Microcredit organization
DD	Due Diligence	M&E	Monitoring and Evaluation
DFI	Development Financial Institutions	MIFT	Ministry of Investments and Foreign Trade of the Republic of Uzbekistan
DFS	Digital Financial Services	MOF	Ministry of Finance of the Republic of Uzbekistan
DPL	Development Policy Loan	MOU	Memorandum of Understanding
DRF	Disaster Risk Finance	MSME	Micro, small and medium enterprises
EBRD	European Bank for Reconstruction and Development	NBCO	Non-bank credit organization
ECA	Europe and Central Asia	NDC	Nationally Determined Contribution
ELA	Emergency Liquidity Assistance	NFIS	National Financial Inclusion Strategy
EPA	Export Promotion Agency	NIM	Net interest margin
ESF	Environmental and Social Framework	NPL	Non-performing loan
ESuF	Export Support Fund	MIC	Middle-income countries
ESMS	Environmental and Social Management System	PAC	Public advisory council
ESS	Environmental and Social Standard	PDO	Project Development Objective
FM	Financial Management	PIU	Project Implementation Unit
FSRP	Financial Sector Reform Project	POM	Project Operations Manual
FSSR	Financial Sector Stability Review	PPSD	Project Procurement Strategy for Development
FX	Foreign currency	PRAMS	Procurement Risk Assessment and Management System
GDP	Gross Domestic Product	RoAA	Return on Average Assets
GRS	Grievance Redress Service	SAMA	State Assets Management Agency of the Republic of Uzbekistan
HR	Human resources	SEP	Stakeholder Engagement Plan
HR	Human Resources	SOCB	State-owned commercial bank
IAIS	International Association of Insurance Supervisors	SOE	State-owned enterprise
ICBP	Uzbekistan Institutional Capacity Building project	TA	Technical Assistance
ICRR	Implementation Completion and Results Report	TOR	Terms of Reference
ICT	Information and Communication Technology	TSS	Thematic Support Specialists
IFC	International Finance Corporation	UFRD	Uzbekistan Fund for Reconstruction and Development
IFI	International Financial Institution	WGI	World Governance Indicators

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DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Uzbekistan	Uzbekistan Financial Sector Reform Project	
Project ID	Financing Instrument	Environmental and Social Risk Classification
P173619	Investment Project Financing	Moderate

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Performance-Based Conditions (PBCs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	[ ] Hands-on Enhanced Implementation Support (HEIS)

Expected Approval Date	Expected Closing Date
24-May-2022	30-Jun-2027

Bank/IFC Collaboration
No

Proposed Development Objective(s)

The project development objective is to support the authorities in restructuring and/or privatizing state-owned banks, increasing financial resilience to disasters, and expanding finance for exporting MSMEs.

Components

Component Name	Cost (US$, millions)
State-owned banks modernization, commercialization, and privatization	9.80

Financial preparedness to disasters and strengthening insurance sector stability	2.70
Development Bank, export and trade financing instruments	1.70
Project Management	0.80

Organizations

Borrower:	Ministry of Finance
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	15.00
Total Financing	15.00
of which IBRD/IDA	15.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	15.00
IDA Credit	15.00

IDA Resources (in US$, Millions)

	Credit Amount	Grant Amount	Guarantee Amount	Total Amount
Uzbekistan	15.00	0.00	0.00	15.00
National PBA	15.00	0.00	0.00	15.00
Total	**15.00**	**0.00**	**0.00**	**15.00**

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2022	2023	2024	2025	2026	2027

Annual	0.00	1.00	4.50	4.00	4.00	1.50
Cumulative	0.00	1.00	5.50	9.50	13.50	15.00

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	Substantial
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Environmental and Social Standards Relevance Given its Context at the Time of Appraisal

E & S Standards	Relevance
Assessment and Management of Environmental and Social Risks and Impacts	Relevant
Stakeholder Engagement and Information Disclosure	Relevant
Labor and Working Conditions	Relevant
Resource Efficiency and Pollution Prevention and Management	Relevant
Community Health and Safety	Relevant
Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
Cultural Heritage	Not Currently Relevant
Financial Intermediaries	Not Currently Relevant

NOTE: For further information regarding the World Bank's due diligence assessment of the Project's potential environmental and social risks and impacts, please refer to the Project's Appraisal Environmental and Social Review Summary (ESRS).

Legal Covenants

Sections and Description
Section I.A.5 of Schedule 2 of the Financing Agreement: The Recipient through MOF shall install, not later than three (3) months from the Effective Date, a module in SCS' accounting software for separately managing the accounting and financial reporting of the Project.

Sections and Description
Section I.B.1 of Schedule 2 of the Financing Agreement: The Recipient, through MOF, shall prepare, in accordance with the terms of reference acceptable to the Association, and furnish to the Association not later than November

15 of each calendar year, during theimplementation of the Project, a work and budget plan containing all activities proposed for inclusion in the Project for the next calendar year.

Conditions

Type	Financing source	Description
Effectiveness	IBRD/IDA	Article IV.4.01 (b) of the Financing Agreement: The Recipient, through MOF, has adopted the POM satisfactory to the Association.
Effectiveness	IBRD/IDA	Article IV.4.01 (a) of the Financing Agreement: The Recipient, through MOF, has hired an environment and social specialist for PIU under terms of reference and resources acceptable to the Association.
Disbursement	IBRD/IDA	Section III.B.1 (a) of Schedule 2 of the Financing Agreement: No withdrawal shall be made for Partial Scholarship Grants under Subcomponent 1.4 (d) unless and until the Recipient has adopted a Partial Scholarship Grant Program Guidelines satisfactory to the Association.

I. STRATEGIC CONTEXT

A. Country Context

1. **Uzbekistan is a lower-middle income country that is rich in natural resources and landlocked, bordering with all other Central Asia countries and Afghanistan.** It has the largest population in Central Asia (more than 34.5 million people as of 2021) with 49 percent living in rural areas. In the past decade, Uzbekistan maintained high and stable economic growth rates (at 6.1 percent on average) and gradually diversified its economy. Gross Domestic Product (GDP) per capita grew from US$1,784 in 2019 to US$1,983 in 2021. Official poverty estimates declined from 27.5 percent in 2001 to 11.5 in 2020. Until the 2017 economic liberalization, these gains relied on an economic model driven by the State's dominance in major productive sectors. As a result, the country has struggled for decades to reach its full economic potential, generate enough good jobs, and stimulate labor force participation—with unemployment levels heavily concentrated among women.[1]

2. **After an initial phase of market liberalization, Uzbekistan is transitioning into a more complex phase of reforms.** Uzbekistan started an ambitious economic transformation which entails three major shifts: from central planning to a market economy, from state to private ownership, and from isolation to economic integration. In 2017, the government approved a five-year (2017-2021) development strategy and started its implementation. It liberalized the foreign exchange market and undertook numerous reforms that, among others, liberalized most prices, removed heavy-handed regulations on business and trade, and overhauled the tax system. State-owned enterprises (SOEs) and state-owned banks (SOCBs) still dominate the economy.[2] Large SOEs enjoy unrivaled market power, preferential regulatory treatment, and preferential access to financial and other resources. They dominate key sectors (e.g., mining, oil and gas, energy, chemicals, aviation, rail, and telecommunications), crowd out private investments, and hinder sustainable growth.

3. **Uzbekistan is prone to climate-related disasters and climate change is expected to increase the disasters' frequency and severity.** The country is facing water scarcity and desertification with 78 percent of Uzbekistan covered by desert.[3] Climate change is leading to further depletion of the Aral Sea. Uzbekistan faces increasing temperatures, more frequent and extreme droughts, lower precipitation levels and changes in weather patterns.[4] Floods already threaten substantial part of the country – they are expected to happen more often.[5] The United Nations estimates the average annual loss (AAL) from disaster events (all excluding droughts) to be US$300 million (and US$700 million with droughts).[6] The country is also prone to other disasters, such as earthquakes that are infrequent but can cause devastating losses. An earthquake similar to the one that has happened in 1966, if adjusted by inflation, would cause losses in excess of US$10 billion in 2020. Global Earthquake Model (GEM) estimates the AAL from earthquakes in Uzbekistan at US$208 million; for a major earthquake (that has one percent chance of happing each year), the loss is projected to be more than

[1] Female labor force participation is 28 percentage points below that of men – nearly twice the average gap in high-income countries (15 pp) and much higher than in comparator countries such as Russia (10 pp) and neighboring Kazakhstan (12 pp).

[2] Over 2,000 SOEs and other public sector activities amount to about half of Uzbekistan's GDP. SOEs account for about 18 percent of employment and 20 percent of exports. State-owned assets are concentrated in fifteen large SOEs, with total assets equivalent to 57 percent of GDP in 2019.

[3] https://www.climatelinks.org/sites/default/files/asset/document/Uzbekistan_CRP_Final.pdf

[4] *https://www.climatelinks.org/resources/climate-risk-profile-uzbekistan*

[5] ttps://climateknowledgeportal.worldbank.org/country/uzbekistan/vulnerability

[6] United Nations, Economic and Social Commission for Asia and the Pacific (ESCAP) (2020). The Disaster Riskscape United Nations, Economic and Social Commission for Asia and the Pacific (ESCAP) (2020). The Disaster Riskscape Across North and Central Asia: Key Takeaways for Stakeholders. *https://www.unescap.org/publications/asia-pacific-disaster-report-2019*

US$4 billion.[7,8] The proposed project aims to address adaptation to climate-induced disasters through financial preparedness for such events as well as for rare and potentially devastating disasters, such as earthquakes.

4. **The COVID-19 pandemic has been the most severe crisis Uzbekistan has faced since independence, underscoring the importance of transitioning to a market economy to achieve the government's ambitious goals.** GDP growth slowed sharply in 2020 to 1.9 percent from 5.7 percent in 2019 due to lockdowns and trading disruptions. Nevertheless, the economic situation steadily improved in 2021, with real GDP growth reaching 7.4 percent in 2021 (Annex 3, Table 1). This recovery was supported by robust agricultural output and a rapid, well-targeted anti-crisis support program in the tune of 4 percent of GDP.

5. **The economic impact of the Russian invasion of Ukraine remains uncertain but will surely put additional pressure on the economy.** Economic growth for 2022 is projected to moderate to 3.6 percent (compared to pre-crisis forecast of 5.9 percent). The largest impacts may come from a sharp slowdown in private consumption and investment growth due to an anticipated 50 percent fall in remittances and weaker demand for Uzbekistan's textile and food exports in Russia. Economic growth may also deteriorate because of indirect spillovers, including the global disruptions to supply chains, the displacement and return of migrant workers and their reemployment challenges, the rising inflation, and the dry-up of external financing which Uzbekistan heavily relies on (including Russian FDIs). There is some uncertainty, however, about how sharply these spillovers will affect Uzbekistan's economic outlook, creating risks for further corrections to the growth outlook. On the positive side, unlike other Central Asian economies, Uzbekistan has limited systemic dependency on Russia's economy and financial sector, and a relatively resilient export base of well-hedged commodity exports, which may help offset negative terms of trade shocks and support Uzbekistan in preserving growth. There may also be unexpected opportunities from the procurement of key commodities such as fuel and food, that are in short supply globally because of failing logistics and disrupted markets.

6. **The conflict in Ukraine is unlikely to trigger major repercussions for the banking system of Uzbekistan in the short-term period, but indirect spillovers and rising credit risk should be monitored.** These mitigated repercussions are thanks to insignificant home-host banking relationships with Russia (no Russian bank subsidiaries in Uzbekistan), insignificant exposures to Russian banks (deposits with or lending to banks in Russia by Uzbek banks), and relatively small share of financing from Russian banks to Uzbek banks. Consequently, no immediate liquidity and market risks are observed. It is still premature to gather a certain view about the transmission channels and the size of the impact that the ongoing conflict in Ukraine can have on the financial sector of Uzbekistan in the medium-term. However, it is likely that Uzbekistan banking system will face increased credit risks—especially from declining remittances and disrupted trade—decreased profitability, potential issues with correspondent banking (in case of regional risks), and jittery appetite from investor appetite and/or changing geopolitical composition of foreign investors in the medium term. Regulatory response and contingency planning for possible repercussions on the banking sector potentially arising from the ongoing conflict in Ukraine is under way by the CBU, and the World Bank is providing the necessary technical assistance.

7. **Looking ahead to the next decade, Uzbekistan's government has pledged to halving the poverty by 2026 and becoming an upper middle-income country by 2030**.[9] These ambitious targets require annual national income growth per person of between 9-10 percent, which the government acknowledged can only be achieved through reduced state

[7] An event with 1 percent Annual Exceedance Probability.
[8] *https://www.globalquakemodel.org/country-risk-profiles/uzbekistan*
[9] The "Strategy for the development of New Uzbekistan for 2022-2026" envisions reaching GNI per capita of around US$4,000 by 2030. In 2021, Uzbekistan also established an official definition of poverty and committed to cutting poverty in half by 2030.

footprint and greater private sector led growth. The government has adopted a new Development Strategy 2022-2026[10] which envisages the achievement of about 100 goals in seven priority areas,[11] which include transformation and privatization of the banking system and SOEs, increasing export potential of the country, addressing environmental issues, including through sustainable and efficient use of its natural and energy resources, and reducing pollution, climate, and environmental impacts,[12] as well halving the unemployment rate among women.

B. Sectoral and Institutional Context

Financial sector overview

8. **Dominating the financial system, the banking sector is primarily state-owned and highly concentrated.** Commercial banks comprise more than 95 percent of total financial sector assets. The banking sector consists of 33 banks, of which twelve are state-owned and account for 81 and 86 percent of total assets and credit by end 2021 respectively (Annex 3, Table 2). The six largest state-owned commercial banks (SOCBs) account for 68 percent of total sector assets. The government directly and indirectly controls over 90 percent of the shares of the SOCBs via MOF, various state agencies and public companies. The Uzbekistan Fund for Reconstruction and Development (UFRD, a sovereign wealth fund) is the largest SOCB shareholder because its funds have often been used to replenish SOCBs' capital. As of 2020, the formal responsibility to exert shareholder rights over SOCBs was transferred to the Ministry of Finance (MoF). By end-2021, another Presidential Decree reinforced the mandated transfer of SOCB state shares to the MoF, which needs to be yet fully implemented.[13] Private banks are small, with an average equity of US$61 million, and mostly serve the private sector on commercial terms. Unlike SOCBs, they fund their operations through retail deposits (about 65 percent of liabilities) with the remaining liabilities sourced from foreign banks and international DFIs.

9. **The non-bank financial organizations and capital markets are underdeveloped.** Non-bank credit organizations comprise microcredit organizations (MCOs), leasing companies, pawnshops and one mortgage refinancing company. The 63 MCOs and 64 pawnshops account for just 0.3 percent of banking sector assets. The Central Bank of Uzbekistan (CBU) is currently developing a new law on non-bank credit organizations, with WB support, to be adopted in 2022. There are more than 100 leasing companies, with a loan portfolio of about 2 percent of banking sector credit. Capital markets are underdeveloped.[14] By end-November 2021, the total market capitalization of listed securities reached UZS 84 trln.

10. **Insurance penetration is very low, despite numerous insurance companies in the market**. Among the 42 life and non-life insurance companies, two companies with majority government stake account for less than 20 percent of total premiums.[15] The profitability of the insurance market reached 9.7 percent (RoE) and 4.8 percent (RoA) in 2020. Of 42 insurance companies, 8 provide life insurance and 34 offer general (non-life) insurance. While the insurance sector grew

[10] UP-60 dated January 28, 2022
[11] Building a people's state through increasing human dignity and further development of a free civil society, Making the principles of justice and the rule of law a most basic and necessary condition for development, Development of the national economy, ensuring its growth at the level of contemporary requirements, Just public policy and human capital development, Providing spiritual development, reforming this field and taking it to a new level, Solving international problems taking into account the national interests and Strengthening the security and defense power of our country.
[12] Uzbekistan is the fifth most intensive greenhouse gas emitter and faces risks from the global policy environment shifts. The country's emissions intensity is more than twice the level of Central Asian peers, and 18 times the Europe and Central Asia (ECA) average.
[13] Only shares of Ipoteka bank have been transferred from UFRD to MOF until now.
[14] The Capital Markets Development Agency was abolished on May 1, 2021 and its functions were transferred to the MoF.
[15] The ADB, under its TA Grant approved in September 2021, will support the IMDA in divesting the government's stake in state insurance companies.

rapidly over the last few years, the product market remains limited and only a small share of the financial system. In 2021, the insurance penetration ratio (gross written premiums to GDP) reached 0.52 percent.[16] Major insurance products include compulsory motor insurance, compulsory employer's liability insurance, contractor's voluntary all-risk insurance, credit risk insurance and property insurance. The life insurance sector is nascent, comprising about 10 percent of gross written premiums. As of 2020, the insurance industry is supervised by the Insurance Market Development Agency (IMDA) under the MoF–which replaced the State Insurance Supervision Department of the MOF. The IMDA is currently working on the development of a new insurance market development strategy.

Key financial sector challenges

Build-up of macro-financial stability risks

11. **Rapid credit growth has been increasing financial stability risks.** The economic liberalization resulted in rapid credit growth driven by increasing retail and private sector demand and larger state funding. After the 110 percent nominal growth in 2017 (partly due to local currency depreciation), credit has grown at about 50-60 percent per annum in 2018 and 2019, before slowing to 31 and 18 percent in 2020 and 2021 (Annex 3, Table 2). Both state and private banks experienced the credit boom, with credit to private sector doubling to 46 percent of GDP in 2016-20 (three times the average annual deepening experienced by Poland, Russia, or Vietnam during their initial transition years). The rapid growth is risky because of poor credit underwriting standards, risk management capabilities, weak corporate governance at banks.

12. **Non-performing loans (NPLs) are rising, and the banking sector capital buffers, while well above the regulatory minimum of 13 percent, may be tested**. Following the low and stable NPLs during 2018-2020 (about 1-3 percent), problem loans hiked in 2021 to about 5 percent.[17] Both public and private banks have seen their loan portfolios worsen, with a significant share of loans receiving multiple deferrals during 2020-2021. The CBU intensified its supervision over proper identification and disclosure of NPLs, but challenges remain. While the banking system is sound overall, with banking system capital adequacy ratio above 17 percent, the capital adequacy ratio may be overstated as several banks need to make additional loan loss provisions. The NPL ratios may further increase as the prior rapid credit growth seasons, Covid induced risks fully surface, and spillover risks from the conflict in Ukraine materialize. In 2021, the net interest margin[18] narrowed to 4.2 percent, providing a limited buffer to absorb further deteriorations in asset quality. Moreover, the three largest SOCBs had highly concentrated (large exposures comprising 58 percent of total gross loans) and dollarized (at about 70 percent) loan portfolios, exposing them to greater solvency risk. In addition, Uzbekistan is exposed to many natural disasters and climate change risks that may substantially (and potentially quite rapidly) increase NPLs in absence of adequate risk management practices and insurance mechanisms.

Large presence of inefficient state-owned banks

13. **Traditionally, SOCBs intermediated funds from the government to priority sectors and SOEs at below-market rates, lacking strong governance, risk management, and oversight.** Loans and advances account for the bulk of SOCB assets (about 80 percent). Preferential lending—about 80 percent of the total loans in 2018—was provided to priority segments such as low-income housing and to support entrepreneurship, agriculture, and other sectors. SOCBs funded their lending activities predominantly with long-term government and UFRD funding. The dependence on state funding

[16] The level of penetration might be an overstatement due to potential double-counting risk as a result of co-insurance arrangements.
[17] The uptake of NPLs was not accompanied by proportional increase in loan loss provisions. The NPL coverage ratio decreased from 64 percent in end-2020 to 46 percent by end-2021.
[18] Pre-provision net interest income to average total assets.

for both capital and liquidity purposes as well as the lending targets for priority SOEs and economic segments resulted in SOCBs lacking any proper governance and risk management systems and capabilities. In addition, SOCBs were often burdened with non-core banking functions, such as tax administration, cash monitoring and reporting on their clients. Furthermore, the supervisory authority lacked effective powers and capacity, and had limited independence to enforce prudent intermediation practices on SOCBs. Such conditions undermined the banking sector competitiveness and created an uneven playing field for private banks.

14. **SOCBs have consistently underperformed private banks and generated high contingent fiscal liabilities**. Over 2015-2020, SOCB profitability (pre-tax return on average assets, RoAA) has been about two to three times smaller than that of private banks. While operating expenses of SOCBs (as share of total assets) have been significantly lower than in private banks due to the size effect, the lower SOCB profitability was mostly due to lower net interest margins (NIM) – the result of preferential loans. Private banks have less dollarized balance sheets, smaller exposure to large borrowers and SOEs, and more independent, foreign, and female board members. Lack of proper capital and liquidity planning in SOCBs resulted in frequent recapitalizations by the UFRD. Restructured large SOEs loans (especially after the currency devaluation) were given regulatory forbearance, which partly explained the traditionally low levels of NPLs in the system (1-3 percent) during 2018-2020.

15. **SOCBs have had little incentives to mobilize household savings.** By end-2020, the ratio of bank deposit to GDP stood at 19 percent with around 40 percent of the deposits belonging to the government and SOEs. Despite a blanket deposit guarantee in place, the history of cash shortages, restrictions on currency conversion, tax administration role of banks, and disruptions in payments systems have eroded the trust of the population in banks. Retail deposits in SOCBs comprised only about 19 percent of total liabilities by end-2021 because SOCBs funded activities mostly from foreign banks and international financial institutions (about 36 percent) and the state (about 25 percent). More recently, SOCBs have managed to attract foreign financing through Eurobond issuance, including in local currency. The incentives for mobilizing domestic deposits are weak due to availability of cheaper and longer-term funding from government and foreign counterparts, despite its potential to strengthen bank funding structure and help households and firms build financial wealth and self-insure against risks.

Low access to finance and financial inclusion

16. **Account ownership in Uzbekistan remains low.** Only 36 percent of adults report owning an account at a financial institution,[19] less than in peer countries (e.g., 47 percent in Tajikistan, 59 in Kazakhstan, 63 in Ukraine, 81 in Belarus). Account ownership is even lower for rural, youth, and less educated population. A 16-percentage point gap in the account ownership exists between the urban (43 percent) and rural (27 percent) populations. Similarly, the distribution of financial access points is uneven with large concentration in bigger cities. The gender gap in account ownership is, however, narrow, compared to Middle-income countries (MICs) and Europe and Central Asia (ECA) – with 37 versus 34 percent difference between men and women. The usage of payment cards and remote banking systems has been rising in recent years.

17. **The access to finance among micro-, small- and medium-sized enterprises (MSMEs) also remains comparably low, hindered by limited instruments addressing MSME needs**. During the post-2017 credit boom, the private sector benefited from improved access to finance. The 2019 Enterprise Survey indicates that 5.8 percent of Uzbek firms perceive access to finance as a major constraint—a lower share than for the regional and income peers (17 percent and 26

[19] IFC 2020 Financial Capability Survey

percent). However, the survey also shows that only 22 percent of firms have a bank loan or credit line (24 percent in 2013)—well below the 28 percent average for lower MICs and 38 percent for ECA.[20] Because financial inclusion efforts have been disproportionately focused on concessional lending to priority segments, SOCBs have not been serving the private sector effectively. Banks have engaged in limited product innovation and marketing to new customers to expand the client base. While most lending products have high collateral requirements, mid-sized firms have the greatest unmatched needs for finance and are more likely to be credit constrained. Low financial literacy among entrepreneurs continues to constrain the role of financial markets in supporting investment and productivity. In addition, the informality of MSMEs[21] and the focus of Uzbekistan's financial sector on formal sector hamper access to finance.

High disaster risk

18. **The capacity of the government, businesses, and people to cope with the costs of climate-induced and other disasters is limited.** The government shoulders a large share of the costs after disasters, including the reconstruction of public and sometimes private assets, emergency response, welfare programs, and fiscal transfers to subnational governments. These liabilities can include support to large corporates and SOEs, especially in utility and transport services, when these are affected by disasters or climate-induced events. The government has limited pre-arranged financing, and a shortfall of funds after disasters may necessitate disruptive budget reallocations and unexpected borrowing possibly at higher costs. In an uncertain environment concerning the impact of the conflict in Ukraine, businesses – especially small and medium, as well as those engaged in agriculture or food processing - might find it more difficult to recover after disasters on their own. Households also have limited access to risk financing and would likely rely on government assistance after climate-induced and other disasters. Disaster insurance penetration is low—less than 10 percent of residential dwellings are insured against FLEXA[22] risks and natural perils. The penetration varies among regions and is primarily driven by mortgage-linked insurance. Even with limited penetration, insurance companies may risk insolvency in case of a major disaster, with insufficient capital and only a few insurance companies buying reinsurance against such major events or considering how climate change affects frequency and severity of weather-related disasters. Any insolvency might result in a shrinking risk capital, while policy holders may not be able to get a full and timely indemnity. The lack of financial preparedness to meet post-disaster costs will further intensify the impacts of disasters on the economy, fiscal position of the government, and people's well-being.

19. **The insurance market faces a range of interconnected acute issues.** The regulatory and supervisory framework is outdated and does not enable the sector to properly manage and transfer risks, provide adequate and affordable coverage, and reliably protect policyholders. Insurance companies confront low insurance penetration, the absence of actuarial capabilities, and outdated IT that negatively affect business models and solvency positions. Risk management in the insurance sector, with limited reinsurance, high risk accumulation[23] and no or limited consideration of climate change impacts on the portfolio, needs significant improvement. The lack of resources for innovation has led to a limited product mix and absence of innovative distribution channels. The lack of clear rules and conditions for indemnity payments in legislation, low financial literacy, and the absence of sound consumer protection further aggravate the situation and undermine public trust in private insurance.

[20] Account ownership is quite high among MSMEs - about 84 percent compared to 95 percent in ECA countries.
[21] According to a study by the National Scientific Centre for Employment under the Ministry of Employment of Uzbekistan, 59.3 percent of workers in 2018 were employed in the informal economy.
[22] Fire, lightening, explosion and aircraft damage.
[23] World Bank. 2020. Disaster Property Insurance in Uzbekistan

Policy response

Financial stability

20. **The CBU has improved its regulatory and supervisory framework, with comprehensive World Bank technical assistance (TA).** Following the adoption of laws on the Central Bank as well as Banks and Banking in 2019, the CBU has self-assessed its regulatory and supervisory framework against the global standards (the Basel Core Principles). The assessment identified major weaknesses in the supervisory approach and the regulatory framework. The CBU has initiated reforms with World Bank TA support (under the FIRST Initiative and FinSAC, Annex 4) in multiple areas: (i) numerous regulations in accordance with international standards; (ii) gradual transition to risk-based supervision for both prudential and AML/CFT areas; (iii) enhancing and improving the quality of the supervisory data reporting under a SupTech initiative; (iv) preparing a system of early supervisory interventions to address problems at banks early on; and, (v) improving the deposit insurance framework and building a new bank resolution framework. In tandem, ADB has been providing TA on bank supervision (inspections), while the IMF will provide TA focused on macroprudential policy, the emergency liquidity assistance, and macroprudential stress-testing. The World Bank has been coordinating closely with ADB and the IMF.

Role of the state

21. **There has been strong progress in implementing banking sector structural reforms since 2019.** In December 2019, large SOE preferential loans funded through UFRD resources were transferred out of the SOCBs' balance sheets back into UFRD– stopping the practice of direct on-lending of UFRD funds through SOCBs, decreasing SOCB exposure to credit and foreign currency risks. This policy action has paved the way for further banking sector reforms and the eventual privatization of most SOCBs. In parallel, measures were taken to wind down the practice of preferential lending, applying interest rate subsidies only where needed. All directed lending programs have been concentrated in three SOCBs that will remain in the public domain for the foreseeable future. As a result, the outstanding preferential loans as a share of total SOCB loans decreased from 78 percent in 2018 to 44 percent in 2021. Continued effective implementation of this policy will help reduce market distortions.[24]

22. **In 2020, a comprehensive Banking Sector Reform Strategy set the reform agenda for the next five years and included the strategic mapping of SOCBs.** World Bank supported the strategy's preparation and approval through TA and DPL. The strategy includes actions to advance SOCB privatization and restructuring, micro and macroprudential oversight, and the development of a non-bank financial providers. The strategic mapping of SOCBs has been performed, but the sequencing of SOCB privatizations needs to be updated. Eight out of twelve SOCBs, representing around 45 percent of banking sector assets, are scheduled for privatization (of the full or majority stake) from 2021 to 2025, including the privatization of at least three SOCBs to strategic investors. This will increase the share of private banking in total banking assets from 15 to 60 percent. A potential for banking sector consolidation can arise from the planned fivefold increase in the minimum capital requirement by 2025. The draft "Strategy for the development of New Uzbekistan for 2022-2026" reconfirms the Banking Sector Reform Strategy.

23. **Following the Strategy, the ownership function and oversight over SOCB restructuring and privatization was centralized in the MoF.** A dedicated Banking Reform Department was established in May 2019, reporting directly to the

[24] One challenge is the need to revisit the definition of "preferential loans", especially for loans in foreign currency, which are currently defined as loans which are financed from UFRD and IFIs, and under the state guarantee.

First Deputy Minister of Finance. The Department has been actively engaging with SOCBs on the development and implementation of transformation plans. However, the transformation processes in SOCBs have been largely inconsistent, urging the MOF to provide structured high-level guidance to the process (vision, high-level objectives, sequence of works, priorities, etc.). The Department is currently facing several issues: (i) the split of work between its divisions should be further clarified; (ii) critical understaffing, with five staff members (including the head of department) and no consultants; and (iii) difficulties with developing and implementing all of the required internal policies and procedures (such as SOCB department regulation, SOCB ownership policy, SOCB Board member appointment procedures, M&E system, SOCB communication policy, privatization procedures, etc.). The Department is tasked to oversee the SOCB restructuring. However, the salary scale of the MoF Department staff is currently well below that of the banking sector, which creates obstacles for attracting and retaining sufficient qualified staff.

24. **Although MOF assumed the main authority for coordinating the transformation of state banks and the preparation of selected SOCBs for privatization, several other agencies may have roles to play in SOCB privatization.** For example, UFRD, SAMA and MIFT may play roles in exerting control, exercising ownership rights and/or participating in the decision-making on the privatization of various SOCBs. These roles need to be formally clarified to formulate shared goals and avoid transaction delays—for the benefit of both stakeholders and prospective investors. These agencies have different functions and do not have established communication channels that would allow them to align their mandates concerning SOCB transformation and privatization. This in turn may dilute the accountability of SOCBs and hurt their performance.

25. **The MoF's ownership and oversight role over SOCBs requires significant strengthening.** The critical priorities include: (i) improving functions of the MOF Banking Reforms Department and building adequate capacities; (ii) developing a coherent and well-structured ownership policy and defining the gap-filling roles of the SOCBs remaining under public ownership to ensure complementarity and competitive neutrality relative to the market; (iii) further reducing directed and preferential lending; (iv) improving corporate governance and risk management practices in SOCBs; (v) formulating privatization strategies and modes for SOCBs, preparing SOCBs for privatization transactions, and ensuring that the designated SOCBs are privatized via transparent and competitive international tenders to attract fit and proper strategic investors; and (vi) ensuring good coordination among the state agencies involved in the restructuring and privatization of SOCB. This will be supported under the Component 1 of the project.

26. **The transformation progress has been uneven across SOCBs.** By end-2021, due diligence (DD) or asset quality reviews (AQRs, non-supervisory) have been implemented in three SOCBs. Most SOCBs have developed and approved transformation plans (with different time horizons) that were vetted by the MOF. New and independent Board members were appointed by the MOF in SOCBs, but, as of end-2021, only one state bank had a majority of independent board members. The share of women Board members remains small or non-existent (Table 1). Importantly, CEOs are still politically appointed and the appointment processes for the Board and executive management members are not fully transparent and clearly regulated.

27. **Several IFIs have been invited to work with some of the largest SOCBs to help prepare their privatization**. Many SOCBs are working with consulting companies (e.g., Deloitte, Ernst&Young, KPMG, PwC, McKinsey, Grant Thornton, etc.) (Table 1). The government also launched the privatization of a few SOCBs. The privatization of Ipoteka bank (9 percent of total banking system assets) advanced during the year, but the finalization of transaction has been suspended by the potential strategic investor due to uncertainties related with recent conflict in Ukraine.

Table 1. SOCB privatization and transformation status

	Bank Name	Total banking system assets, %	Privatization planned	Key IFI partners	Date of latest DD/ AQR performed	Approved transformation plan horizon	# of Board members	o/w independent	o/w women
1	NBU	20	No	None	None	2021-25	7	2	1
2	Agro	9	No	ADB	None	2021-24	8	1	0
3	Xalq	6	No	None	None	2021-22	7	4	0
4	MicroKredit	3	No	None	2020	2020-23	9	3	0
5	UzProm-Stroy	13	Yes	IFC, EBRD, ADB	None	2020-24	8	3	1
6	Asaka	11	Yes	EBRD	2019	None	9	4	2
7	Ipoteka	9	Yes	IFC	None	2020-22	8	4	3
8	QQB	5	Yes	ADB	None	2021-24	9	4	0
9	Aloqa	3	Yes	EBRD, ADB	2019	2021-23	9	0	0
10	Turon	2	Yes	IFC	None	2020-21	9	3	0
11	Poytaxt	0	Yes	None	Ongoing	None	5	0	0
12	UzAgro-Export	0	Yes	None	None	None	7	0	0

28. **The Project will support the MOF in advancing SOCB transformation and privatization following the adopted strategy through financing large scale consultancies and possible investments in ICT systems of SOCBs.** SOCBs need to be restructured and implement governance and operational reforms ahead of privatization to create financially sustainable institutions with sound risk management and corporate governance practices to make them attractive to investors or as they refocus their role under public ownership to achieve both commercial and social objectives. SOCB restructuring combined with transparent privatization will be key for successful banking transition. This will be supported under the Component 1 of the project.

29. **In addition to broader restructuring, the SOCBs need to enhance the knowledge and capabilities of staff, relying on the Banking and Finance Academy (Academy) to help address key gaps in human resources.** The SOCB staff and management lack necessary skills and knowledge in key competencies (e.g., credit underwriting, risk management and internal controls, corporate governance, etc.). A 2020 CBU study identified 16 directions (60 topics) for training, including needs in the context of current transformation efforts. To address these gaps, the Academy will serve as a platform for streamlining training assistance and institutionalizing capacity building programs. The Academy was established in 1996 and was transferred under the ownership and management of the NBU in 2019. It is a highest educational institution for the training of management personnel and specialists in the banking, financial, and tax areas. It also serves as a scientific and analytical center. The Academy has struggled to provide sufficient coverage and depth of short-term educational programs and has focused on serving a limited number of SOCBs. In 2020, a new development concept and action plan for 2020-2025 were approved. Component 1 will provide assistance to the Banking and Finance Academy to help Uzbekistan meet demands for human resource development in the financial sector.

Access to finance and financial inclusion

30. **Uzbekistan adopted its first National Financial Inclusion Strategy (NFIS) 2021-2023 in June 2021, with the support of the World Bank Group.** The NFIS provides a comprehensive approach to improving financial inclusion. It defines national financial inclusion objectives, identifies a prioritized set of actions to achieve those objectives, and outlines the main opportunities and obstacles that policymakers should consider during implementation. The NFIS focuses on five main policy areas for reform actions: basic financial services, access to finance for SMEs, digital financial services, financial consumer protection, and financial literacy. The draft law on non-bank credit providers, developed

with WBG support, is expected to be approved in the first half of 2022. Further assistance to the NFIS activities will be provided by the World Bank under a new TA program.

31. **During the COVID-19 crisis, the government undertook a range of measures to financially support firms including the export-oriented ones.** In addition to partial interest compensation for pre-export financing loans and the partial credit guarantees (through the State fund for support of entrepreneurship), the Government established an Export Support Fund (ESuF) in October 2020 under the Export Promotion Agency (EPA).[25] The Fund's equity in the amount of US$100 million was injected by the UFRD. The latter also provided an additional US$100 million loan to the Fund in 2021 at preferential rate of 1 percent. The allocated US$200 million funds are intended for provision of one-time, short-term, foreign currency pre-export financing loans through commercial banks to exporting companies. As of end 2021, thanks to the ESuF funding, twenty commercial banks intermediated a total of about US$142 million pre-export financing loans to 271 exporting companies, with a total export turnover of about US$471 million. The Government is considering a comprehensive review and assessment of the ESuF's operations and efficiency of its instruments, with the possibility to broaden them. The Project will support the MIFT in reviewing and enhancing the Fund's operations in export financing support. These activities will be carried out under Component 3 of the project.

32. **The authorities have decided to establish a development bank in Uzbekistan**. This decision was delivered in the new Development Strategy 2022-2026 (action 106) approved by the Presidential Decree N 60 in January 2022. Most countries have at least one national developmental financial institution (NDFI), and many countries have more than one. This is the case even in countries with market-oriented economic models such as Chile. NDFIs held about 6.5 percent of global banking assets in 2018, and the creation of new NDFIs has been revived, with more than 70 NDFIs established worldwide over the last decade.[26] NDFIs strive to fill market gaps by catering to riskier segments of the economy underserved by private institutions (e.g. SMEs, agricultural producers, infrastructure projects requiring long-term finance) and business areas in which sovereign guarantees may provide some advantages (e.g. EXIM). The creation of a development bank in Uzbekistan is envisaged, *among others* to support development of large infrastructure and industrial projects in Uzbekistan and development of export potential of Uzbekistan enterprises through the provision of comprehensive financing, guarantee, and insurance support to exporting companies and aggregate exports. While NDFIs can play an important role in addressing market gaps, they can also bring about negative consequences if they are not properly managed, including crowding out private commercial banks and private investments, distorting incentives, and leading to inefficient use or waste of public funds. In the Uzbekistan context, the creation of a new development bank should be supported by a thorough analysis and concept including a clear rationale, value proposition, mandate and additionality of such institution, not to crowd out the private commercial banking (especially as SOCB privatization and transformation proceeds) and considering that several SOCBs slated to remain in public ownership and other public agencies already perform developmental functions. Component 3 of the project will support the authorities with the development and implementation of the new development bank concept, its legal framework and operationalization, including possible integration of export financial support into the newly established development bank.

Disaster risk finance and the insurance sector

33. **To strengthen financial preparedness to climate-induced and other disasters, the government—spearheaded by the MoF—aims to prepare a Disaster Risk Financing Strategy.** Through multi-stakeholder consultations, the strategy

[25] The EPA was created in 2018 under MIFT. In 2020, it was also vested with the function of providing financing to banks for the purposes of allocation of loans for pre-export and export operations.
[26] E. Gutierrez, T. Kliatskova "National Development Financial Institutions: Trends, Crisis Response Activities, and Lessons Learned", 2021

will determine government priorities and policy actions to address disasters of different frequency and severity, relying on analytics and catastrophe modeling prepared by the World Bank. The Strategy's implementation will include design and operationalization of a risk financing instruments that will aim to mobilize private sector co-financing and build on the capacities of the insurance market in Uzbekistan to share risks between the public and private sectors. Relatedly, IMDA has recognized the need for building its capacity to strengthen the regulatory and supervisory framework for catastrophe insurance and its credibility as an independent regulator. Component 2 of this project will support the development of the Strategy and its first phase of implementation.

34. **The government is planning a series of ambitious reforms in insurance, including developing the catastrophe insurance markets.** Since adopting the 2019-2020 insurance market development roadmap, a few reforms have already been initiated. A new law on Insurance Activities was adopted in 2021, and a Presidential Decree on additional measures was signed to digitalize the insurance market. IMDA is preparing its second, five-year strategy (2022-2026), supported by the World Bank. It will focus on: (i) improving the policyholders' protection framework, (ii) reducing the state participation, (iii) strengthening the prudential regulatory and supervisory framework, (iv) expanding the insurance infrastructure, introducing modern ICT systems, and developing human resources, and (v) developing tailored insurance products based on exiting market gaps. The strategy will also address catastrophe insurance, outlining the government priorities in developing catastrophe insurance markets, strengthening the demand for such insurance and the supply of quality products. Component 2 will also provide capacity building support for IMDA for the purpose of strengthening the regulatory and supervisory framework in the insurance sector.

35. **The reforms of banking, insurance, disaster risk financing, and export finance create synergies that can boost the efficiency of financial services and contribute to MSME sector development, productivity, and sustainable growth.** Competitive insurance products and targeted financial support to emerging MSME exporters can help increase creditworthiness of borrowers (firms and their employees) in the transformed banking system. Prosperous firms (and populations) with better protection measures and diversified income a result of physical and human resources investments could become better clients for insurance companies and graduate from export financing programs, possibly creating local supply chain links with MSMEs and deepening local industry development.

C. Relevance to Higher Level Objectives

36. **The proposed project is consistent with the recently completed Country Partnership Framework (CPF) for FY 2016-2020, Report No. 105771-UZ discussed on June 14, 2016 (revised and extended through the 2018 Performance and Learning Review, Report No. 126078-UZ, discussed on June 26, 2018) and is expected to remain closely aligned with the upcoming CPF 2022-2026.** Specifically, Focus Area 1 of 2016-2020 CPF on private sector growth included the sector's access to finance and financial services. To achieve this objective, two types of actions were envisaged: (i) the gradual elimination of key distortions in the financial sector, including directed and preferential lending to public sector entities; and (ii) the progressive removal of specific barriers to MSME access to finance. The project is also consistent with the Uzbekistan Second Systematic Country Diagnostic—specifically on improving allocation of finance—and is expected to remain closely aligned with the upcoming CPF 2022-2026, specifically its Objectives 1.1 Expand Competitive Access to the Market and 1.2. Enable Private Sector Growth and Investment. The project will further contribute to the high-level outcome of enabling a more sustainable and greener growth through strengthened financial resilience to natural disasters.

37. **The proposed project builds on the government's adopted Banking Sector Reform Strategy 2020-2025.** Following the Strategy prepared with the World Bank's assistance, the project aims to support the Strategy's implementation. It will help sustain the momentum for an ambitious program of market-oriented reforms launched in 2017 by ensuring that banking reform activities are comprehensive, well-coordinated across policy stakeholders, and consistent over the medium term. The project–the first financial sector one in Uzbekistan—will remain closely aligned with the government's newly adopted 2022-2026 Development Strategy.

38. **The proposed project complements the ongoing Institutional Capacity Building (ICB) project, as well as the TA on bank regulation and supervision, bank resolution, deposit insurance, and AML/CFT.** SOCB and SOE reforms are deeply interlinked (see Box 1). The project complements components 2 and 3 of the ICB project related to SOE reform, competition policy support, and strategic support for reform coordination by contributing to more neutral conditions for competition from the perspective of financial support channeled through the banking sector. In turn, the ICB project complements the FSRP project by reforming SOEs (major bank clients) toward greater efficiency, market-based functioning, and market discipline. The project also complements the ongoing FinSAC TA support focused on bank regulation and supervision, as well as the current FIRST-funded TA on bank resolution, deposit insurance, and AML/CFT. All these projects are interlinked and reinforce each other through synergies.

39. **The proposed project reinforces reforms supported by past Development Policy Operations (DPOs) and future DPO series, in turn, can help uphold the FSRP project implementation.** The project reinforces the reform path supported by past DPOs (P166019, P168280, P171751),[27] and is expected to inform, complement, and be supported by the future DPO series of the World Bank to help successfully implement reform actions in the financial sector that may require additional high-level policy dialogue and coordination.

40. **The proposed project will contribute toward the World Bank's twin goals: reducing poverty and boosting shared prosperity, the GRID agenda, and Maximizing Finance for Development (MFD).** Transformation and privatization of SOCBs will contribute to macro-financial stability, widen access to financial services to firms and individuals, and deepen the provision of services to underserved segments of the society (e.g., low-income household, rural populations, MSMEs). SOCBs that will remain in public ownership have deep branch penetration, including in rural areas, making them well positioned to foster financial inclusion. The greater availability of diverse risk management and insurance instruments against climate-induced and other disasters for people, businesses, and the government will further support the GRID agenda implementation—notably on both resilient and inclusive development around adaptation risks. The project will support the MFD objective of enabling private sector participation in the financial sector development by enabling competitive and transparent privatizations of SOCBs, entry of private capital (including with IFI co-investments) and attracting private co-investments in disaster risk and export financing.

41. **The proposed project remains relevant despite the recent conflict in Ukraine and its possible repercussions for Uzbekistan's financial sector.** This is due to the following reasons: (i) the proposed project ((sub)components 1.1, 2.2 and 3) finances large-scale capacity building activities for relevant authorities (MOF, IMDA, MIFT), the importance of which increases with the expected challenges ahead; (ii) the disaster risk financing (supported under sub-component 2.1) and the need to protect the economy and state budget from increasing disaster impacts become even more acute in the context of possibly slowing economic growth and the possible need for extra budgetary support for social needs; (iii) the transformation of the state-owned banks (supported under sub-components 1.2 and 1.3) and building human resources

[27] DPO-1 (Foundations for Sustainable Economic Growth and Macro-Financial Resilience); DPO-2 (Increasing the role of markets and the private sector in the economy); DPO-3 (Improving the efficiency, sustainability, and transparency of resource allocation in the economy).

for the financial sector (supported under component 1.4) remain highly relevant for efficient allocation of credit and supporting stable development of the banking system, which, if unchecked, may bring about a financial crisis and put additional pressure on already strained fiscal budget; (iv) improving and enhancing export and trade financing instruments for exporting MSMEs, including possibly through a development bank, becomes even more important as exporters are expected to face difficulties arising from the global disruptions from the ongoing conflict in Ukraine (supported under component 3); and (v) although strategic investor appetite for privatization of local SOCBs may fade in the upcoming 1-2 years due to heightened level of economic and political uncertainties and losses that potential investors may face directly and indirectly, the need for geographic diversification and changing geopolitics may stimulate interest of traditional and new investors in Uzbekistan's banking sector.

Box 1: SOE reform in Uzbekistan

SOCB and SOE reforms are deeply interlinked - the success in banking sector reform requires and supports the progress on SOE reform. SOEs are SOCB's large borrowers and success in SOE reform will determine the quality of SOCB loan portfolio, solvency position, and sound growth prospects. In addition, SOEs are key elements of the production system and play an important role in the country's overall economic performance. Sound banking sector development would be seriously hampered in the absence of broad economic reforms, of which SOE reform is a main component. Furthermore, if SOE reform stalls, bank privatization efforts may be hindered because investors are often reluctant to acquire banks with large SOE exposures. Conversely, transformation of the banking sector, including elimination of preferential lending and allocation of resources according to risk assessments, is necessary to introduce hard budget constraints on SOE and provide stronger incentives for their reform.

In line with experience of former transition economies, financial sector reforms in Uzbekistan have been complemented by simultaneous reforms to support private sector development. Recent policy measures to advance SOE reforms and competition will help improve market conditions for the corporate sector and the banking sector alike. The measures include Presidential Decree 6096 to accelerate the reform and privatization of SOEs; a Resolution of the Cabinet of Ministers (#674) to improve the disclosure of information by SOEs, and the creation of UzAssets, as a wholly owned subsidiary of SAMA.

As a first step, a strategic mapping of SOEs, as well as ownership and governance frameworks, has been completed in 2020. Presidential Decree 6096 separates SOEs into several groups: (i) SOEs that are classified as currently strategic and that will be subject to corporate transformation and governance strengthening; (ii) SOEs that are non-strategic but carry inherent value requiring pre-privatization support and individual privatization assessments; (iii) lower-value SOEs that will be privatized via public auctions; and (v) state assets—such as property—that will be sold.

Early SOE corporate governance reforms are critical for more efficient operation of strategic SOEs, successful privatization of other SOEs, and more market-based functioning of the banking sector. Presidential Decree 6096 sets several ambitious targets for strategic SOEs that will remain in the Government's ownership (Annex 1 and 2 of the Decree). Achieving these targets will be a significant challenge given limited institutional capacity and resources. To advance reforms of companies listed under Annex 1, MOF has established a dedicated department to manage the performance and transformation of large strategic SOEs. Technical support to this new department, as well as to SAMA and other MOF departments supporting SOE reforms is provided under the World Bank Institutional Capacity Building project.

In March 2021, the government adopted a five-year SOE reform strategy. The strategy was developed with the support from the World Bank and EBRD. It outlines the strategy for the management and reform of SOEs for 2021-2025, a roadmap for its implementation in 2021-2022, as well as target parameters. Under this strategy several ensuing reforms are planned, including: (i) development of new laws "On State property management" and "On Privatization", (ii) measures to end preferential policies for SOEs and strengthen competitive neutrality, (iii) adoption of a new principle "sell or explain" aimed at privatizing those SOEs which will not meet the strong rationale (selection criteria) of remaining under state ownership (to reduce the number of SOEs by 75 percent), (iv) transformation of state unitary enterprises into economic companies and separation of the state ownership and regulatory functions, (v) improvement of corporate governance and transparency of SOE, including via establishing Boards, internal audit and compliance functions, and attracting independent Board members (at least 30 percent by 2025), as well as requiring SOEs to publish financial statements and regularly report on their activities to the Parliament. Due implementation of the SOE reform strategy is critical for successful implementation of the banking sector reform and achievement of the current project's objectives.

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

42. The project development objective is to support the authorities in restructuring and/or privatizing state-owned banks, increasing financial resilience to disasters, and expanding finance for exporting MSMEs.

PDO Level Indicators

(i) Number of privatized SOCBs (with more than 50 percent of shares divested);

(ii) Number of SOCBs slated to remain in state ownership, in which majority of Board members—including Board Chairman—are independent;

(iii) Government's funding gap regarding disaster risk financing reduced according to the adopted disaster risk financing strategy thanks to newly introduced policies/instrument(s);

(iv) Beneficiaries reached with financial services.

B. Project Components

43. **The project has three technical components and a project management component**. The project total estimated cost is US$15 million (see Table 2). The project will finance primarily advisory services (i.e., hiring of consultants), funding of IT (hardware and software) and Management Information Systems (MIS), trainings and workshops.

Table 2. Project Components and Estimated Costs

Components	Estimated cost, US$, millions
Component 1: State-owned banks modernization, commercialization, and privatization	**9.8**
1.1: Consultancy support and institutional capacity building for MOF to support the ownership function over SOCBs	2.2
1.2: Consultancy services to support SOCB restructuring	3.2
1.3: Support to modernize SOCBs' core ICT infrastructure	2.4
1.4: Support to the Banking and Finance Academy	2.0
Component 2: Financial preparedness to disasters and strengthening insurance sector stability	**2.7**
2.1: Develop a national disaster risk financing strategy	1.2
2.2: Capacity building for IMDA	1.5
Component 3: Development Bank, export and import financing instruments	**1.7**
3.1: Technical assistance to MIFT to support the establishment of a development bank in Uzbekistan	1.0
3.2: Technical and institutional building support to the EPA and ESuF in improving and enhancing its export, import and trade finance products	0.7
Component 4: Project Management	**0.8**
Total Amount of All Components	**15**

Component 1: State-owned banks modernization, commercialization, and privatization (US$9.8 million)

44. **The component will support the implementation of the adopted banking sector reform strategy**. The ultimate objective is to rationalize state ownership in the banking sector to a point where the number, size, and reach of the SOCBs are commensurate with the state policy objectives, and support development of human resources for early and successful banking system transformation.

45. **Sub-component 1.1: Consultancy support and institutional capacity building for MOF to support its ownership function across SOCBs (US$2.2 million).** This sub-component will provide support to the MOF in the following two main areas:

a) Strengthening the MOF's ownership and oversight function for SOCBs, including: (i) support further operationalization of the MOF Banking Reforms Department; (ii) develop a coherent and well-structured SOCB ownership policy and regulations; (iii) develop and improve the M&E system for assessment of performance of SOCBs against the KPI targets established under the approved restructuring plans; (iv) deal with SOE and problem loans on SOCB's balance sheets ahead of privatization; (v) develop communication and raising public awareness about SOCB restructuring and privatization program; and, (vi) provide capacity building for the MoF Banking Reforms Department.

b) Transactions-oriented TA to MOF (and SAMA as needed) for privatization of select SOCBs, including consultancy services to: (i) formulate recommendations for the privatization strategy and appropriate privatization mode, as well as the sequencing of SOCB privatizations, (ii) develop procedural guidelines for various aspects of privatization, (iii) prepare and bring approved privatization deals to the market; (iv) prepare valuation reports, prospectuses, and bidding documents; (v) organize international, open and competitive tenders/biddings; (vi) evaluate bids and select winning investors; and, (vii) close on privatization transactions, in coordination with the CBU conducting the fit and proper assessment of potential shareholders, including all necessary legal services.

In cases when, according to the approved privatization procedural guidelines and other relevant legal documents, some or all SOCB privatization procedures will be conducted by SAMA, this sub-component will also provide transactions-oriented and capacity building consultancy support to SAMA, as needed.

46. **Sub-component 1.2: Consultancy services to support SOCB restructuring (US$3.2 million).** This sub-component will support: (i) conducting diagnostic analyses for SOCBs, including AQRs, due diligence assessments, ICT audits, special diagnostics, market studies, and merger or acquisition feasibility studies, to be carried out by independent auditors, consulting firms and lawyers; (ii) review and assessment of SOCB business models, operations and policies, including HR management policies; and, (iii) preparation or update of SOCB transformation/restructuring plans based on the conducted diagnostic analyses and their implementation. The support will be provided to SOCBs with no support from other IFIs and consulting companies, or if the MoF identifies the need of undertaking additional analysis and consultancy support from the SOCB owners' or system perspective (in coordination with the CBU).

47. **Sub-component 1.3: Support to modernize SOCBs' core ICT infrastructure (US$2.4 million).** This sub-component will finance investments in SOCBs to modernize core infrastructure and to support the commercialization of SOCBs, specifically ICT systems and infrastructure, internal control and risk management systems, digitalization of bank process to reduce operational costs/risks and improve overall operational efficiency. The implementation of such investments could be undertaken with consultancy support where needed. This subcomponent will predominantly focus on the ICT modernization of the SOCBs that will stay in public ownership but may also support SOCBs marked for privatization (on

a cost-sharing basis with the bank owners and other IFIs (these investments will be recovered later through an increased sale price)). The project will also support the development of sound Environmental, Social and Governance (ESG) risk management systems in selected SOCBs, which will enhance the government efforts to reduce the risk of climate and geophysical hazards, and fiscal contingent liabilities, which will help to transition to climate-informed lending portfolios. Specifically, enhancing participating SOCBs' ESMS system to align with the World Bank's ESF and ESS could strengthen the SOCBs' capacity to better manage and monitor environment and social risks in their operations. This can include developing a climate risk screening mechanism for the participating banks to screen their (potential) investments for climate-related risks and adopting recognized greenhouse gases accounting methodologies for their investments. This will also comprise targeting training on climate risk screening and the greenhouse gases accounting methodologies under sub-component 1.4.

48. **Sub-component 1.4: Support to the Banking and Finance Academy (US$2.0 million).** This sub-component will support the Academy in four major areas:

a) **Targeted, specialized, and continuous short-term trainings for all levels of banking and financial sector specialists and people interested in financial sector careers for human resource development in the financial sector.** This subcomponent will address the immediate, short-term and medium-term human resource needs of banks, especially, SOCBs in their restructuring efforts and financial sector regulators (including CBU, MOF, IMDA). The following actions will be supported: (i) conduct a comprehensive training needs (demand) and supply analysis; (ii) develop a formalized training master plan including prioritization of trainings; (iii) design, build and roll-out the training program;(iv) develop an evaluation system to assess the level of satisfaction of both the participants and their employers, and (v) develop necessary internal process, procedures and regulations for the Banking and Finance Academy for effective and efficient implementation of the short-term trainings, including the selection criteria and process of hiring trainers with necessary knowledge, skills and experience. Where needed, the Academy will cooperate and coordinate with IFIs and other academic institutions that also provide relevant trainings.

b) **Training of Trainers program.** The sub-component will aim to create a local pool of trainers that will be able to deliver required training programs at scale, ensuring the sustainability of the Academy's efforts including in relation to the inclusion and diversity agenda once the project ends.

c) **Certification programs.** The sub-component will identify priority certification programs, implement necessary activities to enable holding international certification examinations in Uzbekistan, and, where needed, design and implement specific training programs to assist the candidates in preparing for these examinations.

d) **The partial scholarship grant program for people who want to pursue new career in the financial sector and compete for financial sector jobs.** The sub-component will partially finance the tuition fees of Banking and Finance Academy students who want to pursue new career in the financial sector for the short-term trainings mentioned in sub-paragraph (a) and (c) above as needed. The partial scholarship grants shall be provided according to the partial scholarship grant program guidelines developed and approved by the Banking and Finance Academy with the support provided under sub-paragraph (a) and to the extent acceptable to the Bank, and as incorporated to the Project Operations Manual. The partial scholarship grant program guidelines should outline, among other things, the terms and conditions of the partial scholarship grants, eligibility criteria and selection/evaluation procedures for partial scholarship grants beneficiaries, partial scholarship grant payment mechanisms, as well as monitoring and reporting requirements. The beneficiary eligibility criteria shall pay particular attention to gender and regional aspects, with the objective to maximize the benefits for most disadvantaged groups. The total budget for individual partial scholarship grants will be limited to US$200,000 over the first two years of the project since its effectiveness date. After the first two years of the project since its effectiveness date, the effectiveness of training partial scholarship grants will be jointly evaluated by the Banking and Finance Academy, MOF, and the World Bank. If the implementation is deemed successful, the budget for partial scholarship grants can be extended over the remaining period of the project and be limited to additional US$500,000 out of the total funding allocated for this sub-component.

The activities of this sub-component will be closely coordinated with the CBU's Department for Improving Financial Literacy and Retraining Banking Specialists.

Component 2: Financial preparedness to disasters and strengthening insurance sector stability (US$ 2.7 million).

49. **This component aims to: (i) strengthen financial preparedness of Uzbekistan to climate-induced and other disasters; and (ii) improve catastrophe insurance market regulation and supervision.** This component consists of two sub-components**.**

50. **Sub-component 2.1: Develop a national disaster risk financing strategy (US$1.2 million).** This sub-component will support the MOF in developing and implementing a national disaster risk financing (DRF) strategy and action plan to strengthen financial preparedness to physical impacts of climate change and other disasters through a better financial planning and safeguards. It will help protect the economy and state budget from the increasing disaster impacts, alleviating climate and disaster impacts on businesses and households—especially the most vulnerable—and ensuring enough financing is available when and where it is most needed. The activities include preparation of the DRF strategy and its implementation, specifically:

a) **Development of a national DRF strategy:** This sub-component will support the preparation of a national DRF strategy, including identifying and quantifying government contingent liabilities due to climate induced (and thus impacted by changing climate) and other disasters. The strategy will define the government's risk appetite on what risks to retain versus transfer, and design a corresponding risk layering approach to address increasing disaster costs, both from frequent and rare disasters. The sub-component will finance analytics, consulting services, preparation of the strategy and action plan, and capacity-building/awareness increasing activities for all relevant stakeholders. This strategy will determine priorities in management of the government contingent liabilities and set out actions to address these priorities. These actions may focus on improving the existing risk financing instruments and/or introducing new and more diversified ones based on a risk layering approach (i.e., combining different sources of financing). The MoF will lead the development in coordination with multiple government stakeholders. Specifically, the work will be implemented in coordination with country stakeholders responsible for data (e.g. hydromet, statistics) and disaster risk management (in addition to other sectoral stakeholders, such as those involved in public asset reconstruction, providing funds to the affected people, agriculture, etc.) both in the government and development partners. This work will be supported by a funding gap assessment and catastrophe risk modeling developed through an upstream World Bank TA. This includes Disaster Risk Management technical assistance funded by the European Union, implemented in close collaboration with World Bank Disaster Risk Management team.

b) Support implementation of a national DRF strategy: Based on the adopted DRF strategy, this sub-component will support the design and operationalization of a risk financing instrument, such as a reserve fund or centralized insurance pool that addresses climate-induced and/or other disasters. In particular, the sub-component will finance: (i) a feasibility study for a DRF instrument as provided in the DRF strategy implementation plan; (ii) the technical design of structuring the instrument, standard operating procedures and other operational documents thereof; (iii) implementation of the reserve fund's or centralized insurance pool's funding structure, governance, staffing, audit and reporting; (iv) implementation of a risk financing plan that is reviewed and updated annually, potentially leveraging on (re)insurance sector; (v) risk-based pricing, finance infrastructure and operational enhancements, under potential PPP; and (vi) if required, draft of a presidential resolution or other law or regulations on the reserve fund/insurance pool, based on international experience and comparable private sector structures.

51. **Sub-component 2.2: Capacity building for IMDA (US$1.5 million).** This sub-component aims to strengthen the IMDA capacity to regulate and supervise the insurance sector in line with IAIS core principles, including on catastrophe risk insurance. It will finance consultancy services to: (i) review and improve IMDA's organizational structure; (ii) introduce a modern regulatory reporting system on climate-induced and other disaster risks; (iii) increase IMDA's capacity to set up rules, regulations, and guidelines to improve insurance products and market practices; (iv) develop risk-based supervisory framework to assess and monitor risks, including climate related risks and addressing potential impacts of climate change; and (v) provide capacity building and training for IMDA staff (including through on-the-job training, exchange visits), including on disaster risk insurance. The project will also finance the IMDA's ICT infrastructure for data collection and data management. The World Bank will coordinate closely with the ADB that also provides support to IMDA on upgrading the regulatory framework, divesting state ownership in insurance companies, broadening investment mandates, and cross-regulatory cooperation. This work is supported through an upstream World Bank Disaster Risk Management TA, which funded a review of the insurance strategy regarding catastrophe risks to contribute to the draft Insurance Sector Development strategy.

Component 3: Development Bank, export and trade financing instruments (US$1.7 million).

52. **This component aims to: (i) support the establishment of a development bank in Uzbekistan; and (ii) support improvement of export and trade financing instruments that the development bank can later house.** This component consists of two sub-components**.**

53. **Sub-component 3.1: Technical assistance to MIFT to support the establishment of a development bank in Uzbekistan (US$1.0 million).** This sub-component will support the MIFT in developing and implementing the concept note for creating a new development bank in Uzbekistan. In particular, the project will finance consultancy services to:

a) Develop the concept note for a new development bank in Uzbekistan;

b) Draft a law or separate legal act for the establishment and operation of the new development bank, in line with the adopted concept, and other related necessary regulations;

c) Develop the technical design of the development bank, including its strategy, financial model and instruments, operational policies and procedures, corporate governance and risk management system.

54. **Sub-component 3.2: Technical and institutional building support to the EPA and ESuF in improving and enhancing its export, import and trade finance products (US$0.7 million):** This sub-component will finance: (i) consultancy services to conduct a comprehensive review and assessment of the ESuF's operations and efficiency of its

export and trade financing instruments, with the possibility to broaden them; (ii) capacity building for the staff of EPA and ESuF on export/import and trade finance instruments, including through fact-finding and study visits to solid foreign partners for on-site learning; and (iii) conducting financial education and awareness workshops for exporting MSMEs (especially in remote regions) to increase awareness and understanding of the export and trade financing instruments offered by ESuF (or development bank) through commercial banks.

Component 4: Project Management (US$0.8 million).

55. **This component will finance the functioning of the project implementation unit (PIU[28]) and overall project implementation and management costs,** specifically: (i) incremental implementation costs for project management, monitoring, project audits, staff costs and other project related operating expenses (including office equipment, travel, communication, printing, translation, and transportation) in the PIU at the MoF that will, among other things, manage the provision of financial resources, perform fiduciary functions, ensure compliance with environmental and social safeguards, monitor and evaluate the project; and, (ii) just-in-time TA (contingency), which will involve financing of activities that contribute to the achievement of the PDO but were not identified during the project preparation.

56. **Climate Co-benefits.** The project has the potential to generate significant climate co-benefits by integrating climate change considerations throughout three of its components. Below is an outline of how these components address adaptation to climate change:

- **Component 1: Investments of US$2.4 million in sub-component 1.3 and US$2 million in sub-component 1.4 will generate climate co-benefits, along with some indirect benefits generated from the sub-component 1.2.** Under Component 1, ambitious reforms and policy changes are envisaged across the banking sector in Uzbekistan. The country faces major climate change challenges, which include the impact of climate-induced events, and also the impact on economic sector and natural resources of Uzbekistan. The Uzbek financial sector is rather insensitive to climate change risks and mitigation efforts in its allocation of capital. This project will address this gap and support some initial reform in this area:
    - *Incorporating ESG governance principles in SOCB governance and developing a climate risk screening guidelines* for SOCBs to spearhead the financial industry's screening of investment lending for climate-related risks (physical and transitional) and adopting recognized greenhouse gases accounting methodologies for their investments and lending under sub-component 1.3.
    - *Targeted training on climate change adaptation and mitigation* will be carried out under sub-component 1.4.
    - *Through other components, the project will generate data on climate-induced and disasters* that will improve understanding of disaster risk and climate change costs and adaptation opportunities and inform the business plans and processes of financial firms and regulators. Such data can inform future regulatory requirements, improving oversight in banking and insurance sectors with regards to climate-induced and other disasters. In turn, this will help implement adequate risk pricing, ultimately contributing to financial resilience of the banking and insurance sectors, making sure they can cover the costs of disaster risk and have adequate funds for timely payouts of insurance claims and sustained lending. The data availability and stronger resilience of banks and insurance companies will reduce the likelihood of NPLs because households and businesses will receive funds more quickly after an event—especially if parametric insurance tools can be developed.

[28] Here and in the text below the PIU refers to the already established PIU under the ongoing Institutional Capacity Building (IBL) project (P168180).

- **Component 2: Most of this component generates climate co-benefits**. Each year, Uzbekistan faces climate induced disasters. More than two third of annual average loss is due to such hazards as drought, flood, and other disasters. Earthquakes are much less frequent than climate-induced disasters but have very damaging impact. Component 2 helps the government adapt to the physical impacts of climate change and prepare for major shocks through financial preparedness and contribute to increased stability of insurance market to better protect people covered by catastrophe insurance. By implementing Component 2, the government can reduce response time and speed up recovery after climate disasters. It can lessen the indirect economic impacts of climate shocks and strengthen response and recovery for households and businesses, while safeguarding financial sector from physical impacts of climate change.[29] Specifically, it includes the following measures:
    - *Investments of US$1.2 million in disaster risk financing sub-component 2.1* will: (i) generate information on physical impacts of climate-induced disasters and how they translate into government contingent liabilities – convening MOF to proactively consider this type of liability; (ii) articulate government strategic priorities in addressing financial preparedness to climate-induced disasters (helping the government to move from currently reactive to proactive approach); (iii) develop a risk financing instrument to manage these contingent liabilities. It will also build capacities for the stakeholders, especially at MOF, to identify and be financially prepared to climate-induced events and other disasters.
    - *Investments of US$1.5 million in insurance sub-component* will address catastrophe insurance protection in Uzbekistan aiming to: (i) strengthen the government's regulatory and supervisory capacity over catastrophe insurance markets, its capacity to identify risk of accumulation, exposure of the market to disasters and companies' financial solvency; (ii) increase sustainability of catastrophe insurance market through prudential regulations and supervision; (iii) create an effective IT system which can allow to track risk accumulation and analyze reporting by insurance companies; and (iv) build capacity and train people on supervision of climate-related risks.
- **Component 3: The Development Bank concept will incorporate ESG governance principles to screen for climate change risks and other environmental risks.** The Development Bank concept, institutionalization, and funding, and activities will be climate change informed following the good practices outlined by the Network for Greening the Financial System (*https://www.ngfs.net/en*). Its governance shall reflect the latest ESG principles and screening of financed activities for their climate change mitigation and adaptation potential. The risk management of the DB will consider both physical and transition risks from climate change in its active risk control procedures. The DB is likely to have a dedicated financing line for climate mitigation and adaptation projects.

57. **Citizen Engagement**: Engagement of Uzbek citizens on the financial sector reform issues is crucial and has already begun with a widescale participatory consultative process for the Banking Sector Reform Strategy 2020-2025, which engaged all relevant public and private stakeholders, including Banking Association of Uzbekistan, business representatives as well as several other business associations. Equally important will be the dissemination of the National Financial Inclusion Strategy that shall communicate and educate the population and MSMEs about the benefits of

[29] The mitigated indirect adverse effects include more available data on risks and hazards that can help strengthen prudential regulations and oversight in banking and insurance sectors. In turn, this strengthening will help reduce defaults of banks and insurance sector, making sure they can cover the costs of disaster risk and have adequate funds for payouts and sustained lending. The data availability and stronger resilience of banks and insurance companies will reduce the likelihood of non-performing loans because households and businesses receive funds more quickly after an event—especially if parametric insurance tolls can be developed.

inclusive, reliable, and competitive provision of financial services that a banking sector functioning on market principles can deliver.

58. **The project will support MOF's efforts to keep the business and financial community informed of the financial sector reform progress**. Public dissemination of information materials (on the MOF website and in various professional and business publications) will ensure transparency of project activities. In addition, the project will ensure pro-active, two-way feedback processes through several citizen engagement activities, including: (i) a beneficiary feedback mechanism for all trainings of the Banking and Finance Academy supported under this project through organizing feedback questionnaires to assess the level of satisfaction with the quality of training received and to provide participants the opportunity to suggest how to further improve the trainings regarding quality and engagement (Sub-Component 1.4); (ii) an annual survey of the employability of the Academy graduates–to be commissioned through the HR Departments of the SOCBs and other banks– will complement the Academy feedback mechanism, will ensure gender related disaggregation of results (Sub-Component 1.4), and will be completed with annual graduates´ roundtables to disseminate and discuss the results of the beneficiary feedback mechanism, as well as any follow up actions since the previous survey round; (iii) consultations will be carried out for the development of the DRF strategy and development bank concept note with key government stakeholders, non-governmental organizations and private sector, and (iv) an annual survey of exporting MSMEs will be commissioned to track the opinion of exporting MSMEs on expanded opportunities for export and trade finance instruments. The project will also consider developing a Feedback App to enable citizens and MSMEs to provide just-in-time feedback on how they perceive the banking system reform and how it impacts their access to financial services. A beneficiary feedback indicator – share of citizens/ MSMEs who report that the project has established effective citizen engagement processes (through the feedback mechanism, surveys, roundtables and consultations)–is integrated in the project results matrix to measure the quality of the citizen engagement activities.

59. **Gender:** Uzbekistan's legal framework for gender equality and women's rights is relatively strong (CPF FY16-20). However, its practical implementation remains weak. On average, only 20 percent of Uzbekistani women participate in the labor market, compared with 46 percent of men. In recent years, Uzbekistan has lowered gender disparities in the labor market, but more can be done to increase women's participation in economic activity. Across economic sectors, a stronger gender parity concerning women employment can be found in health care, physical culture, sports, social security sectors, education, culture, arts, science, and science services sectors, with female employment representing about 72-82 percent.[30] However, in the financial sector, female employment lags behind with 41 percent female employment share on average in the past years.[31] The gender gap in the financial sector employment is driven by the banking sector where the boards of directors, executive management, and heads of regional branches remain male-dominated (share of female Board members and female Executive Management members constituted 7 percent in state-owned banks in end 2021).[32] The issue of underrepresentation of women in financial sector employment is partly a result of occupational segregation (due to societal expectations) which leads to a narrower pool of female candidates with qualifications in finance. This underscores the importance of access to skills and capacity enhancement opportunities that will be supported by the project (subcomponent 1.4). Recent studies find evidence that greater participation of women in the financial system increases financial stability and enhances economic growth.[33] The MOF will be undertaking dedicated outreach to fill the SOCBs board member positions—including with women—by recruiting qualified, high-integrity professionals that meet the CBU's minimum fit and proper screening criteria.

[30] Romanova, Ekaterina, Nina Kolybashkina, Bradley Hiller and Evgeny Kochkin. 2017. "Diagnostic Study of Barriers for Strengthening Livelihoods of Low-Income Rural Women in Uzbekistan." World Bank, Washington, DC, p. 10
[31] Ibid, p.11
[32] The number of SOCBs with at least 15 percent women in Board and Executive Management of SOCBs was 2 out of 12 as of end 2021.
[33] Sahay, M. R., & Cihak, M. M. (2018). Women in Finance: A Case for Closing Gaps. IMF Staff Discussion Note 18/05. Washington, DC: International Monetary Fund.

60. **The project will support female employment and female representation in Board and executive positions of the SOCBs**. Under Component 1, as part of the corporate restructuring packages for the selected SOCBs, the project will develop a good practice manual on gender policy, strategies, and procedures, and will make it mandatory for implementation with the support of the MOF. The main purpose of a corporate gender policy will be to ensure women's enhanced access to banking sector jobs and reducing gender gap in bank management. Gender policies aimed at facilitating new positions for women as Board members and executive managers in the SOCBs will seek to ensure: (i) competitive remuneration, (ii) appropriate environment free from gender-based violence, (iii) where possible, gender quotas in hiring (at least in the short run), opportunities for upward mobility, flexible hours, and childcare support (employer-provided or subsidized).

61. **The project will support gender balance in short-term trainings to be conducted by the Banking and Finance Academy with the support of the project.** To measure progress towards closing this gap, the results matrix includes relevant intermediate results indicators to track gender balance in the pool of students trained by the Banking and Finance Academy. The inclusion of such targets will help ensure greater female representation in those trainings, which will be critical for ensuring access to skills and capacity enhancement opportunities for women and leading to equal access to opportunities in financial sector careers.

62. **The improvement of data collection and change in bank hiring practices will boost gender equality**. Under Component 1, the project will work with the respective department of the MOF to initiate revision of the existing personnel HR policies in the state banks nation-wide to enhance career opportunities for female employees and to encourage recruitment of new female staff by SOCBs. The project will support the CBU, where needed, in collecting and publishing disaggregated bank-level data on male and female employment in aggregate, and with breakdown for different managerial levels including the board of directors. The data should be published once a year on the CBU on its website.

63. **Component 2 will pay particular attention to increasing the representation of women in training, preparing the DRF, and management positions of the reserve fund/insurance pool**. To measure progress towards closing this gap, the results matrix includes the relevant intermediate results indicators. The inclusion of such targets will help ensure greater female representation in the management of reserve fund/insurance pool, which international evidence shows can bring about a range of benefits, such as good governance, effective leadership, and integrity. Evidence elsewhere (e.g. South Asia) has also demonstrated that women's perspectives are vital in developing effective national DRF strategies.[34]

C. Project Beneficiaries

64. **The Uzbek citizens and MSMEs are the ultimate beneficiaries of the project and will benefit from a stable and efficient banking system, as well as increased access to finance and risk mitigation instruments.** The direct project beneficiaries are SOCBs themselves, the government agencies and officials (MOF, MIFT, IMDA, Export Promotion Agency), Banking and Finance Academy, who will benefit from enhanced tools, capacities and a new operating environment supporting market-oriented reforms. Indirect benefits for private banks will come from the reforms focused on leveling the playing field among private banks and SOCBs.

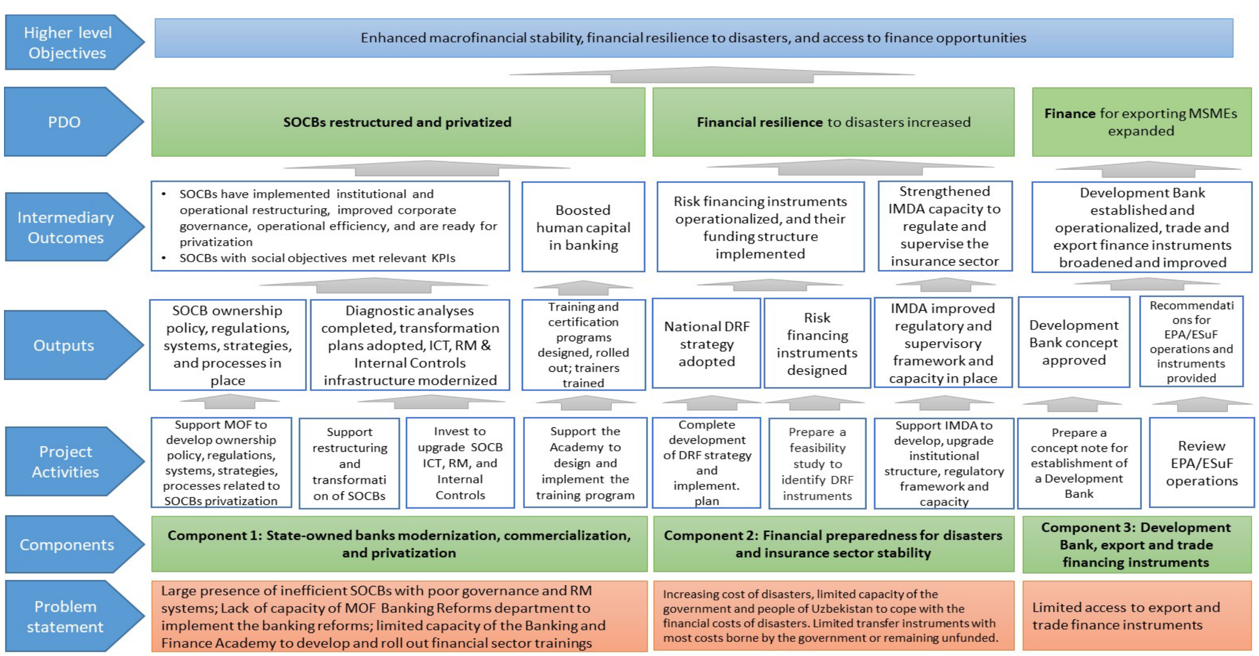
[34] Clements, R. Sneddon A., Budmir, M and Brown, S. "Gender Inclusive Disaster Risk Financing", Practical Action Consulting for the START Network, July 2021
"Applying a Gender Lens to Climate Risk Finance and Insurance", November 2018, InsuResilience Global Partnership Secretariat

65. **More broadly, restructuring and privatizing SOCBs is critical for Uzbekistan's economic transformation, social cohesion, and shared prosperity because advancing financial inclusion enables access to economic opportunities**. In the absence of banking sector reform, the system could experience financial distress that eventually could compromise economic stability and hamper economy-wide reform efforts. Bank business models must be transformed to discourage the reliance on public sector funding and its repercussions for efficient credit allocation, and to stimulate urgent deposit mobilization. Privatization and restructuring of SOCBs, in tandem with SOE restructuring, can trigger more efficient allocation of resources to productive investments and wind down the practice of distortive directed lending that enables the survival of unviable firms. As the Uzbek economy undergoes sweeping reforms and private sector growth restrictions ease, many firms will seek external financing to scale up and grow. Improving MSME access to finance will help spur dynamism in the economy, innovation, and job creation. Advancing financial inclusion of individuals and MSMEs can help many more seize better development opportunities, boost MSME productivity, and share prosperity much widely by empowering marginalized groups, such as women, youth, and rural communities. Financial inclusion in insurance services, specifically, can also improve household and MSME resilience to shocks and disasters. By implementing the national DRF strategy, the government can reduce response time and speed up recovery after climate disasters, which can help lessen the indirect economic impacts of climate shocks and strengthen response and recovery for households and businesses, while safeguarding financial sector from physical impacts of climate change.

D. Results Chain

66. **The Theory of Change is summarized in the Figure 1.** The critical assumptions are: (i) sustained commitment by the Government on the identified reforms; (ii) continued support by internal and external stakeholders on the reforms; (iii) availability of reasonable demand from strategic investors to invest in the banking system of Uzbekistan; (iv) availability of highly competent and specialized technical advisors to support the reforms.

Figure 1. FSRP Theory of change



E. Rationale for Bank Involvement and Role of Partners

67. **The project builds on an ongoing World Bank TA engagement**. The World Bank's involvement in the financial sector reform was initiated in 2018, providing a wide array of TA support to both the CBU and MoF, including on critical areas such as the reform of the banking legislation, adoption of the banking sector reform and national financial inclusion strategies, and improvement of bank regulatory, supervisory, resolution and deposit guarantee frameworks. These activities have laid the foundation for further reforms in the financial sector.

68. **The World Bank's involvement in bank restructuring/privatization and DRF reforms in Uzbekistan and region positions the World Bank well to accompany these reforms.** The government considers the World Bank as its key strategic economic adviser. In this regard, the value-added of the World Bank would be in providing knowledge and experience gained from supporting banking sector reform in other countries (e.g., Egypt, Myanmar, Poland, Vietnam, Ukraine, etc.). Consultations with development partners such as the ADB, EBRD, IFC and others will be actively sought and coordinated. Finally, conducting bank privatization procedures with the World Bank's support will ensure transparent and competitive implementation, as well as consistency of approaches over the medium term.

69. **The choice of the financing instrument is critical for ensuring consistency and successful implementation of the government's reform agenda in the financial sector**. The World Bank's financing operation is needed to ensure consistency in the bank transformation and/or privatization process across all SOCBs over the extended period that the process requires. Consistency is even more important for such a politically sensitive reform agenda, and with various SOCBs currently cooperating with different IFIs. While the involvement of other IFIs is highly beneficial, efforts should be well coordinated, and the project aims to support such effective coordination across the GoU and IFIs, with the MOF in the lead as per the relevant Presidential decree. The key features of this project design can help the authorities stay on track with the stated reform objectives and plans anchored in the banking sector reform strategy. They can help mitigate the risk of diverting from sound practices—such as open competition for and fairness of the privatization deals thanks to proper transparency and consistent communication approach.

70. **Various IFIs (ADB, EBRD, IFC, IMF) are actively financing complementary activities to support financial sector reform in Uzbekistan** (Table 3). The pre-privatization support of the IFIs to selected SOCBs is critical and under way. This support is provided in line with the adopted Banking Sector Reform Strategy, where the government underlined the importance of a two-staged privatization process for most SOCBs, with pre-privatization support and initial privatization conducted by IFI, followed by full privatization of the reformed SOCB to a strategic investor. This operational modality leverages the know-how and reputational signal that IFIs bring into the process when they help guide the SOCB reforms and take a partial equity stake. Specifically, know-how in corporate governance, business strategy, and commercial operations are typically lacking in SOCBs and are highly valuable in reforming them. Other benefits of the IFI involvement include partial burden sharing of the cost of reforms, including necessary investments. The IFI pre-privatization and transformation support to SOCBs, coupled with the MOF's unbiased and systemic oversight, strategic inputs on the direction of SOCB transformation and the type of strategic investors to attract—aimed at ensuring adequate system diversity and diverse provision of financial services commensurate with the structure of the economy and its comparative advantages—will help yield positive outcomes.

71. **World Bank-IFC collaboration in the financial sector is close and synergetic.** The WB team regularly consults regulatory initiatives and policy issues and collaborates with the IFC team on upstream market readiness for regulatory reform. For instance, the two teams collaborated on the development of the National Financial Inclusion Strategy which

drew on the IFC survey of financial capabilities in Uzbekistan and the knowledge of upstream readiness of the emerging subsector of non-bank credit institutions to play a role in implementing the strategy. The IFC team has provided useful inputs into the project design and preparation through several discussions. The IFC and World Bank teams often exchange experience from working on SOCBs transformation from the policy perspective and transformation progress from the perspective of potential investors.

Table 3. Complementary Activities to FSR by Other Donors

Donor	Complementary Activities
IFC	Since 2016 IFC supports the transformation of the two SOCBs (Ipoteka bank and UzPSB) ahead of the privatization. IFC has provided Ipoteka bank a US$35M senior convertible loan and has recently approved an additional US$50m senior loan as well as a limit of US$1.5 million in loan equivalent exposure, for FX swaps. IFC committed a pre-privatization senior loan of US$75 million (to be disbursed in UZS) to UzPSB in September 2021. In addition, IFC is seeking to mobilize up to US$100 million of additional similarly structured investments in UzPSB from ADB and EBRD, while also considering pre-privatization support for a third bank, Turon Bank. IFC is involved in DFS/Fintech-related eco-system development in Uzbekistan. IFC has conducted assessment of the legal framework for DFS development and conducted supply and demand size analysis on opportunities for DFS/Fintech players to operate efficiently in Uzbekistan. As a result, series of regulatory reforms were launched under the signed agreement with the CBU, including support for the implementation of e-money regulations, agent banking, digital onboarding, regulatory sandboxes, and others.
EBRD	Since 2019, the EBRD has been supporting pre-privatization efforts in four SOCBs (Ipoteka, UzPSB, Asaka and Aloqa banks). The support includes provision of finance and advisory capacity building initiatives in selected areas. In particular, a convertible loan in the amount of US$50 mln is to be provided to UzPSB in H1 2022 in addition to equity structures (investments) currently being discussed with the authorities for Asaka bank and Aloqa bank. The EBRD support is also provided to the overall banking sector of the country. In total the EBRD has extended EUR 236.4 mln and EUR 242.5 mln of financing to 10 partner financial institutions in 2020 and 2021, respectively. In 2021, the EBRD completed joint project with the CBU in the area of developing and launching a remote identification system (RIS) for local banks. The work in the areas of inflation targeting, liquidity forecasting and management, and the interbank markets development are ongoing. Another area of the EBRD focus is development of derivatives through review of current legislation and completion of the first test swap transaction.
ADB	ADB has been providing TA support to CBU on risk-based supervision framework since 2019. ADB assisted several SOEs, including the state-owned water utility company, and state-owned banks (i.e. Agrobank, QQB, Aloqa, Xalq Bank) in conducting diagnostic studies to help them identify and develop transformation strategies and roadmaps. In September 2021, the ADB approved a new TA project aimed, among others, at supporting the Uzbek authorities in divesting the state ownership in insurance companies, upgrading regulations to comply with international standards and strengthening insurance supervision. ADB supported SAMA to strengthen corporate governance practices of SOEs. ADB also supported MOF to develop roadmaps and capacity building to facilitate transition to IFRS-based financial reporting by SOEs.
IMF	IMF conducted a diagnostic Financial Sector Stability Review (FSSR) mission in end 2020. A report and FSSR TA roadmap were prepared. In a follow-up TA, IMF will support the CBU in areas related to macro stress-testing, macroprudential policy framework (including ELA) and systemic risk analyses.

F. Lessons Learned and Reflected in the Project Design

72. **The project has taken on board several lessons learned from the implementation of the ongoing ICB project**. One issue with the ICB project relates to the procurement process that is hindered by insufficiently clear and well documented TORs as well as unclear procurement processes in some cases. As a result, the TOR processing by the tender committee is delaying the project implementation. The proposed project will ensure that PIU is fully supported by the MOF Banking Reforms Department and expert consultants in developing clear and well-documented TORs that require technical specialization. Another critical aspect is streamlined decision-making clearly explained in the Project Operations Manual that can help avoid unnecessary delegation of decision-making powers to higher level authorities. A clear and streamlined POM will be prepared based on the ICB project experience. The institutional fragmentation is another issue that may hinder sound and timely decisions on project activities. Although the MOF assumed the main authority for coordinating the transformation and privatization of SOCBs, several other agencies may have roles to play in SOCB privatization. Therefore, a procedural guideline for privatization of SOCBs shall be developed and approved after the project becomes effective—notably to clarify the roles of various state agencies in SOCB privatization. Finally, considering the significant amount of time needed to establish a cross-institutional project steering committee, clarify its operational setup and decisions to be made by this body, as well as the additional bureaucracy and limited effectiveness of such committee in the ICB project, the proposed project does not envisage setting up such committee for the financial sector reform activities. Coordination among various agencies will be conducted through dedicated working groups as needed.

73. **The benefits of TA in advance of project preparation is an important lesson learned from other World Bank projects**. The technical analysis and support provided under trust-funded TA have allowed to speed up project preparation and improve the project design, as both parties—the World Bank and the client—are now better informed about the banking and insurance sector reform challenges and the areas of intervention that could benefit from World Bank's support. The adoption of the banking sector reform strategy has been preceded by some critical reforms supported by the World Bank, including an extensive analysis of local banking at the time relative to international good practice. The recommendations involved a clear roadmap for restructuring and privatization of SOCBs. A more recent comprehensive analysis of the financial sector was performed as part of Uzbekistan's Country Economic Memorandum (CEM, 2021), as well as annual Country Policy and Institutional Assessments (CPIAs). World Bank TA support and project supervision will continue the stream of strong analytics throughout the project implementation.

74. **Other past World Bank projects on SOCB reform and privatization offer valuable lessons learned that are considered in the project design.** The recent IEG's review of SOE reforms supported by the World Bank Group over the 2008-2018 period divides the success factors at project level into two categories – external, i.e. factors not directly controlled by the World Bank Group, and internal, i.e. factors under the World Bank Group's direct control.[35] Longer implementation periods of reform projects allow more time for hands-on operational support and corrective measures during the reform process. The project envisages engagement of the World Bank during the full period of implementation of the banking sector reform strategy to ensure that the medium-term components of the reform program are properly and consistently implemented.

75. **The simpler project design has proven beneficial for successful implementation.** Complex project designs undermine effectiveness, potentially overwhelming both client capacity and the World Bank supervisory capacity,

[35] World Bank, 2020. State Your Business! An Evaluation of World Bank Group Support to the Reform of State-Owned Enterprises, FY08–18. Independent Evaluation Group. Washington, DC: World Bank.

ultimately calling for costly project restructurings, reversals, or missed opportunities due to lost focus and momentum. Projects with multiple components, various counterparts, and several project implementation units are especially susceptible. A lesson learned from the Bangladesh project[36] highlight that a separate, dedicated operation rather than a component in a complex project—involving both privatization of manufacturing SOEs and banks—would have been better for addressing SOCB reform. The proposed project is designed as a standalone financial sector project (separate from SOE reform supported by ICB project), has only three technical components, and will be supported by a single PIU.

76. **Adaptability of the projects—another key success factor—requires a longer-term engagement with the counterparts to enhance their capacity to conduct the reforms**. Long-term engagement and mobilization of multiple complementary and sequential instruments have helped build the needed capacity. The Mali project[37] reveals that project design should factor in the capacity of the country to implement reforms. The capacity building support that the MOF will receive as an inherent part of this project builds on World Bank's three-year engagement with both the CBU and MOF (since the economic liberalization), as well as complementary support provided by other IFIs (ADB, EBRD and IFC) to MOF, CBU, and SOCBs directly. The project team composition involves a strong local presence—a lesson learned from Mali—that help strengthen the policy dialogue, coordination efficiency, and response timeliness.

77. **Strong support and commitment by the government to reforming the financial sector, coordination and synergies among donors, as well as strong communication campaigns are critical to project success**. Financial sector reform has ranked high among the government priorities since the economic transformation started. The reforms to date, notably the adopted banking sector reform strategy and its gradual implementation, demonstrate a strong reform commitment—including in the area of insurance market development where the project will support the IMDA in preparing the second five-year strategy. Despite the COVID-19 challenges and the recent conflict in Ukraine, the authorities have reconfirmed their strong commitment to continued reforms in the banking and insurance sectors to achieve greater efficiency and competitiveness. The World Bank maintains a strong dialogue with both the government and donors (ADB, EBRD, IMF, IFC) to further cement a solid partnership based on comparative advantage. Egypt project experience[38] highlights that consultations and effective communication strategy with stakeholders can mitigate opposition to reform because they help enhance the credibility of reform program and anchor realistic expectations. The adoption of banking sector reform strategy in Uzbekistan was followed by a massive communication campaign with TV interviews and briefings as well as articles on the internet. These initiatives will be continued and expanded as needed through the Stakeholder Engagement Plan (SEP).

78. **The experience of many countries shows that financial liberalization, when not paired with proper regulation and supervision, has led to banking crises.[39]** Studies show that probability of banking crises conditional on financial liberalization is higher than the unconditional probability of banking crises. Relevant lessons highlight the importance of fostering fundamental changes in credit allocation policies by the restructured—but not yet privatized—state banks, using a new healthy incentives and effective managerial, institutional, operational, and financial practices. A lesson

[36] Implementation Completion and Results Report on an IDA Credit to the People's Republic of Bangladesh for an Enterprise Growth and Bank Modernization Project, World Bank, June 23, 2011

[37] Implementation Completion and Results Report on a Credit to the Republic of Mali for Financial Sector Development Project, World Bank, December 17, 2008

[38] Implementation Completion and Results Report on a Loan to the Arab Republic of Egypt for Financial Sector Development Policy Loan, World Bank, February 21, 2007

[39] Carmen Reinhart, Kenneth Rogoff "banking crises: An equal opportunity menace"

learned from Pakistan[40] reveals that enhanced regulatory and supervisory capacity can improve bank efficiency and competition. This project and other ongoing World Bank TA support focus on improving: (i) corporate governance, risk management and internal control systems of SOCBs, including with the IFIs support, (ii) human resources in financial sector through the Banking and Finance Academy, (iii) the MOF's capacity in its SOCB oversight role, including through establishment of sound monitoring and performance evaluation systems for SOCBs, (iv) IMDA's regulatory and supervisory framework, and (v) CBU's regulatory and supervisory framework through the ongoing FIRST and FinSAC TAs.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

79. **The overall implementing agency for the project will be the MoF, and the First Deputy Minister of Finance—assisted by the head of MOF Banking Reforms Department—will oversee the project implementation.** The First Deputy Minister of Finance will strategically oversee project implementation, monitor progress, and ensure overall project alignment with stated objectives and results. The First Deputy Minister of Finance will act as a focal point for communication with the World Bank team on project-related issues. The MOF Banking Reforms Department will support the First Deputy Minister of Finance in implementing the day-to-day project activities.

80. **The First Deputy Minister of Finance will be supported by the PIU Director who will manage the PIU**. The PIU is already established under the ongoing Institutional Capacity Building (ICB) project (P168180) and will also support the implementation of this project. The PIU under the MOF will ultimately be responsible for fiduciary duties, including procurement, financial management (FM), environmental and social management, contract management, M&E, and reporting. The current staffing capacity of the PIU will be expanded as needed to ensure effective implementation of this project. Specifically, the PIU should hire a dedicated project coordinator, and a environmental and social specialist. The details of the PIU structure and staffing requirements will be reflected in the POM as described below. Where needed, the PIU will be supported by the MOF Banking Reforms Department and the consultants hired to support this department, as well as other expert consultants (e.g. with regard to ICT modernization related procurements), to help develop clear and well-documented ToRs that require deep technical specialization. Any critical changes to the PIU organizational structure, mandate, or authority shall be pre-agreed with the World Bank.

81. **Relevant ministries will provide technical leadership and oversight for each project component.** Component 1 and 2 will be technically led by the MoF, and Component 3 will be technically led by MIFT. Under each component, sub-components may have beneficiary agencies different from the component leads. For example, other beneficiary agencies of Component 1 will be SAMA, the Banking and Finance Academy, and CBU (with regard to the training program), the IMDA will be one beneficiary under Component 2, and EPA and ESuF will be beneficiary agencies of Component 3 (see Table 4). Each of these beneficiary agencies will nominate a key focal point no later than three months after the project effectiveness. Inter-agency working groups will be established, as necessary, to ensure close coordination and ownership at the technical and operational levels.

[40] Implementation Completion and Results Report on an IDA Credit to the Government of Pakistan for Banking Sector Development Policy Program, World Bank, January 17, 2006

Table 4. Project Management Responsibilities[41]

Component/Project Management Areas	Component 1	Component 2	Component 3
Overall Project Management/Oversight, Component Implementation, Coordination and M&E	MOF		
Component Technical Oversight	MOF	MOF	MIFT
Fiduciary (Procurement process/ Financial Management, Environmental and Social management)	MOF through its PIU		
Technical coordination of developing TORs, managing consultants, validating and accepting the results and deliverables under the ToRs/consultancy contracts	MOF, Banking and Finance Academy, SAMA, CBU	MOF, IMDA	MIFT, EPA, ESuF

82. **The project will be implemented based on a Project Operations Manual (POM).** The POM will include the following information: (i) the detailed description of project implementation activities, their sequencing and the prospective timetable; (ii) the institutional arrangements as well as decision-making procedures and responsibilities for the implementation of the project; (iii) the project administrative, procurement, financial management and disbursement requirements and procedures; (iv) the plan for the monitoring, evaluation, and supervision of the project and the results indicators; and (v) the plans for mainstreaming citizen engagement and gender considerations into the project.

83. **The project will be implemented for a period of 5 years (2022-2027).** Details of the implementation arrangements are provided in Annex 1.

B. Results Monitoring and Evaluation Arrangements

84. **The MoF through the PIU will be responsible for conducting overall M&E of project implementation and results achievement**. The PIU will report–on a biannual basis–on implementation progress, results achieved, and issues that impede progress and results to the MoF and the WB.

85. **For monitoring and evaluating results, the project's results framework (Section VII) will be utilized, and progress will be disclosed to the public**. In addition to the outcomes identified in the results framework, project progress will also be validated against external indicators, where applicable. The project will be subject to regular implementation support missions conducted by the World Bank. The progress assessed during these missions will be reported by the World Bank team to its management through Implementation Support and Results Reports (ISRs), which will include a review of key implementation issues and performance indicators. The results will be disclosed through the ISR on the World Bank's external website for the project. The MOF is encouraged to publish the project status on its website. In the third year of project implementation, a midterm review will be conducted. The Results Framework may be revisited and

[41] Allocation of the functional responsibilities among the state agencies can be adjusted as per changes or amendments in the government structure.

updated during the midterm review or as and when necessary to ensure continued relevance and achievement of desired outcomes. Upon completion of the project, an Implementation Completion and Results Report (ICR) will be prepared.

C. Sustainability

86. **The Uzbek authorities remain strongly committed to continuing reforms in the banking and financial sector as part of the economic transformation**. The Strategy for the development of New Uzbekistan for 2022-2026 reconfirms Uzbekistan ambition, as set in its Banking Sector Reform strategy adopted in May 2020—namely, to complete the transformation of the banking system and bring the share of private banks to 60 percent of total banking assets by 2025. The MoF has strong ownership of the project and its planned activities. The World Bank team, as well as the authorities will continue closely coordinating the reform activities with other partners (IFIs).

87. **The commitment of the Uzbek authorities to reforming the financial sector is also reflected in the prior reforms undertaken by the authorities, with the World Bank support.** As discussed above, this includes reform of the legal framework (laws on Central bank, Banks and Banking, Insurance Activities, etc.), gradual wind-down of preferential lending, cleanup of SOCBs balance sheets, nomination of independent directors to the SOCB Boards, and the strengthening of the CBU's regulatory and supervisory framework. The World Bank team has been actively supporting the authorities in majority of these reforms, including the adoption of the Banking Sector Reform strategy, ensuring alignment of views and a strong foundation on which the proposed project is built. Despite the strong commitment to continued reforms in the financial sector, risks may arise from potentially poor coordination and some disagreements among various ministries and agencies directly and indirectly involved in the SOCB restructuring and privatization processes. There might be organic tendency to hold on to existing SOCBs, continue with directed/preferential lending practices to support priority sectors and SOEs, and/ or exert efforts to privatize SOCBs via non-transparent processes. To some extent, the risk is mitigated through concentrating the ownership and bank restructuring/ privatization functions in the MoF. However, apart from MOF, UFRD, SAMA and MIFT may have roles to play in the privatization of state banks and these roles need to be formally clarified for the benefit of stakeholders and prospective investors.

88. **The authorities have actively participated in the preparation of this project.** Initial discussions at the concept stage included high-level management from the MOF and CBU. The First Deputy Finance Minister, Deputy Governor of the CBU, Deputy Minister of MIFT, EPA Senior Management and Director of the IMDA participated in the discussions and provided guidance throughout the process.

89. **The project promotes the sustainability of the banking and financial sector reforms from several perspectives**. Component 1 will support the Banking and Finance Academy in building the human resource potential for the financial system of Uzbekistan that should professionalize the industry for the long term. Building a cadre of professional experts and managers in various aspects of banking and finance (such as risk management, internal controls, AML/CFT, corporate governance, etc.) will be critical for ensuring well-functioning, efficient and sound operations of banks in the long-term as the banking system evolves, expands, and diversifies. The human resource build-up is needed irrespective of the pace and direction of privatization efforts because public or private owners will need to rely on the local cadre of professionals. Component 1 is designed to ensure sustainability of supported training programs beyond the project lifespan, including via the Training for Trainers program. Furthermore, Component 1 is designed to specifically support human resource and capacity building of MOF with the purpose of building a strong and specialized Banking Reforms Department with critical functions reaching beyond the project's lifespan because several large SOCBs are slated to remain in state ownership in the foreseeable future. Beyond knowledge and skills, the project will install credible internal procedures, systems, tools,

and policies to foster clarity and professionalism in the state's ownership role, while reducing the scope for political economy. The privatization of most SOCBs and restructuring of the largest SOCBs slated to remain in public ownership shall reduce distortions in the banking system and level the playing field for private financial institutions. Under component 2, the adopted national DRF strategy will ensure a steady flow of funds into pre-arranged financing structures either a public finance or risk transfer ones (or their combination). Component 2 will also support institutional strengthening of the IMDA, through capacity-building and training, staffing, development of operational procedures in line with good DRF practices. By strengthening the broader insurance market, it will increase the sustainability of a DRF instrument. Component 3 will build capacity at MIFT and the Export Promotion Agency under MIFT for promoting trade finance and export financing instruments, which if implemented successfully, would have long-lasting benefits on the product quality and outreach of trade financial intermediation. The creation of a development bank could be a transformative step for development financing, its professionalization, governance, and impact. Many development financing activities and policy lending are weakly governed and their proper risk management is lacking from the point of view of their reach, financial market distortions, mobilization of private finance, and fiscal contingent liabilities the create. Best practice development bank can consolidate and sustainably run the many development financing activities that the country runs or envisages.

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis (if applicable)

90. This project is primarily a TA project that does not lend itself to a traditional cost-benefit analysis.

Economic impact

91. **The proposed project aims to reduce the government's direct participation in the banking sector and build a more resilient, effective, inclusive, and competitive banking system led by private sector banks**. Extensive government ownership in banking hinders financial development as it entails a lower access to the formal banking system, less depth in the credit market, and lower financial innovation.[42] This in turn affects economic development and poverty reduction through the lower mobilization of savings and lower financial intermediation. Besides, extensive use of preferential loans and subsidized credit distort credit markets and competition. Therefore, the expected benefits of the project are to: a) improve the soundness and efficiency of the banking system, supporting the economic development of the country through the improved mobilization of domestic financial resources and expanded financial intermediation; b) increase access to efficient and higher quality financial services for financing investment while lowering transaction costs; c) increase assistance to low-income entrepreneurs through the development of a digital factoring platform and alternative financing instruments, and d) improve fiscal accounts and reduce fiscal risks as a result of privatization proceeds received, increased tax revenues thanks to growth acceleration caused my more efficient allocation of credit, reduced pressure on

[42] Barth, J., Caprio, G., and Levine, R (2000). "Banking systems around the globe: do regulation and ownership affect performance and stability?" World Bank Policy Research Working Paper, no 2325, April.
La Porta, R., Lopez-de-Silanes, F., and Shleifer, A. (2002). "Government ownership of banks." The Journal of Finance 57.1: 265-301.
Cull, R., Martinez Peria, M.S., and Verrier, J. (2018). Bank ownership: Trends and implications. The World Bank.
Cull, R., Peria, M. S. M., & Verrier, J. (2017). Bank ownership: Trends and implications. IMF Working Paper 17/60. Washington, DC: International Monetary Fund.

state funding of credit growth and reduced risks of SOCB insolvency, which may otherwise call for the government to provide financial support to both SOCBs and private banks.

92. **A more dynamic, heterogeneous banking sector is more resilient**. Banking systems dominated by SOCBs depend on continuous government support and funding, providing incentives for the misallocation of credit. SOCBs may extend credit on an unsafe and economically unsound basis to meet broad developmental goals. Government ownership and operation of banks may undermine the effectiveness of supervisory activities. Poor performance of commercial state-owned banks may call for frequent bailouts resulting from poor governance, risk management, and lending decisions of SOCBs. Solvency problems at poorly run government banks could lead to liquidity problems if depositors withdraw funds. This in turn could spill over into a general liquidity crisis for private-sector banks, despite supervisors' efforts to promote their safety and soundness. Furthermore, state-owned banks' decisions to allocate funds to state-owned enterprises could result in the crowding out of other, more creditworthy, borrowers.[43] Finally, lack of trust in government and financial institutions translates into lower formal intermediation. Many studies have shown that bank performance typically improves after privatization.[44]

93. **The fundamental transformation of SOCB business models and operations from the previous "state-agent" role to a new "commercially oriented" banking role will ultimately help the private sector access better financial services**. As a result, the private sector will also suffer less from the distortions created by directed and preferential lending that has benefited the survival of inefficient and non-viable firms. The strengthening of SOCB commercial functions will also help create a level playing field between state and private banks. Positive effects will arise from increased bank competition in collecting deposits, granting loans, and overall providing financial services that are more affordable and suited to the risk profile of the customers (all on a commercial basis).

94. **Privatization of banks had a greater positive effect when banks were sold to strategic and reputable investors through open and competitive bidding process.** Several studies have shown that the most successful method of privatization is sale of a state-owned bank to strategic and reputable investors[45] through open and competitive bidding process that are accessible to all investors, including foreign investors.[46] A recent study by Bertay et. al (2020), covering about 500 bank privatizations in 70 countries in emerging and advanced economies during the 1995-2017, shows that

[43] Cevik, S. (2020). You are suffocating me: Firm-level analysis of state-owned enterprises and private investment. Journal of Comparative Economics, 48(2), 292-301.
[44] Boubakri, N., Cosset, J. C., Fischer, K., and Guedhami, O. (2005). Privatization and bank performance in developing countries. Journal of Banking & Finance, 2015-2041.
Clarke, G., Cull, R., and Shirley, M. (2005). "Bank Privatization in Developing Countries: A Summary of Lessons and Findings." Journal of Banking and Finance 29: 1905–30.
Otchere, I. (2005). "Do Privatised Banks in Middle- and Low-income Countries Perform Better than Rival Banks? An Intra-Industry Analysis of Bank Privatization." Journal of Banking and Finance, 2067–93.
Bertay, A.C., Calice P., Kalan, F.A.D., and Masetti, O. (2020). "Recent trends in bank privatization", World Bank Group, Policy research working paper 9318, July.
[45] Hawkins J. and Mihaljek D. (2001). "The banking industry in the emerging market economies: competition, consolidation and systemic stability – an overview." BIS Papers, No 4, August.
Bonin, J., and Wachtel, P. (2002). "Financial sector development in transition economies: Lessons from the first decade."
Mako, W. (2021). "An efficient economic transition: three cases". Unpublished manuscript. World Bank. Washington D.C.
[46] Clarke, G., Cull, R., and Shirley, M. (2005). "Bank Privatization in Developing Countries: A Summary of Lessons and Findings." Journal of Banking and Finance 29: 1905–30.
Megginson, W. L. (2005). "The economics of bank privatization." Journal of Banking & Finance 29.8-9: 1931-1980.
Bertay, A.C., Calice P., Kalan, F.A.D., and Masetti, O. (2020). "Recent trends in bank privatization", World Bank Group, Policy research working paper 9318, July.

majority of bank privatizations involved governments selling their equity publicly in their domestic capital markets, which brings significant state revenues. Less than 5 percent of privatization of banks in lower-middle income countries occurred through private sales. The adopted Banking Sector Reform Strategy of Uzbekistan has also stressed the need to reduce the state ownership through the competitive sale of shares to strategic investors.

95. **Further lessons derived from privatization experiences of other countries refer to pace, sequence and approach to privatization.** Other key lessons learned from privatization reforms include the following: a) in transitions, privatization of state-owned banks had a greater positive impact when it was total rather than partial,[47] b) privatization in certain cases (such as Hungary and the Czech Republic) required prior cleanup of state-owned bank balance sheets and operational restructuring, making the privatization as the last and not the first step in the transformation process,[48] c) the benefits of privatization are the weakest for countries where it was rushed the most, such as in Eastern Europe[49] and where it was not paired with institutional strengthening of regulatory and supervisory framework,[50] and d) the success of banking sector reform is dependent on and supports the reform of the state-owned enterprise (SOE) sector.

96. **There are sound justifications for state-ownership of banks in a market-based economic system, with clearly defined developmental mandates.** Due to market failures or profitability considerations, private financial institutions underserve certain market segments and thus provide the main rationale for state intervention. Some state-owned banks could, for example, focus on financing large infrastructure projects, in which the need for large amount of long-term funding and the existence of external social benefits provide the rationale for state intervention. State-owned banks with a wide network in rural areas where private banks are not present, may act as a financial agent for the disbursement of government funds such as social subsidies. State-owned banks may also be tasked with countercyclical lending during period of crisis. However, where market failures do exist, direct state-ownership is not always the optimal solution because government regulation and contracting could be better alternatives than direct state-ownership in banks to address the market failures. In practice, state-owned banks typically fail to have clearly defined developmental mandates for addressing market failures, and many have mandates that are vague and hard to measure to set accountable key performance indicators.[51] In the absence of clearly defined mandates, state-owned banks often compete with private banks for the same clients and businesses.

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[47] Ehrlich, I., Gallais-Hamonno, G., Liu, Z., and Lutter, R. (1994). “Productivity Growth and Firm Ownership: An Analytical and Empirical Investigation.” Journal of Political Economy, 102(5), 1006–1038.
Megginson, W. L., and Netter, J.M. (2003). "History and methods of privatization." International handbook on privatization: 25-40.
Clarke et. al (2005)
Bonin, J., Hasan, I., & Wachtel, P. (2014). Banking in transition countries. BOFIT Discussion Paper No. 8/2014
Beck, T., Crivelli, J. M., and W. Summerhill (2005). “State Bank Transformation in Brazil - Choices and Consequences.” Journal of Banking and Finance 29 (8-9): 2223–57.
48 Hawkins and Mihaljek, 2001
[49] Megginson and Netter, 2003
[50] Azam, J.-P., Biais, B., and Dia. M. (2004). “Privatization versus Regulation in Developing Economies: The Case of West African Banks.” Journal of African Economies 13 (3): 361–94.
Reinhart, C. M., and Rogoff, K.S. (2013). "Banking crises: an equal opportunity menace." Journal of Banking & Finance 37.11: 4557-4573.
Estrin, S., and Pelletier A. (2018). “Privatization in Developing Countries: What are the lessons of recent experience”, The World Bank Research Observer, 2018-02-01, Vol.33 (1), p.65-102.
[51] Ferrari, A., Mare, D.S., and Skamnelos, I. (2017). "State ownership of financial institutions in Europe and Central Asia." World Bank Policy Research paper 8288.
Fernández-Arias, E., Hausmann, R. and Panizza, U. (2020). "Smart Development Banks." Journal of Industry, Competition and Trade, Springer, vol. 20(2), pages 395-420, June.

97. **Refocusing the remaining SOCBs and the development bank toward well-defined economic, social, and political objectives will complement the activity of private banks and foster access to finance**.[52] Explicitly defining the mandate of state-owned banks (both commercial and development) and improving their corporate governance can help in limiting the economic costs related to the state banks' political remit and relative inefficiency. Privatization and restructuring of SOCBs will facilitate a more efficient allocation of resources away from directed lending that creates distortions and enables the survival of inefficient and non-viable firms. Bank competition will foster financial innovation, helping reach the underserved segments such as low-income households, rural populations, micro, and small firms. Fostering access to finance and financial inclusion for specific segments of the population, economic sectors, or asset classes may become a specific mandate for some development banks.

98. **Private ownership alone does not guarantee economic gains because key pre-conditions, including a stable macroeconomic environment and competitive privatizations are critical to attaining positive outcomes**.[53] Restructuring and privatizing SOCBs must be matched with institutional strengthening to avoid subsequent costly financial crises and complete economic transitions successfully. The experience from transition economies highlights the importance of financial sector institutional strengthening in shaping successful economic transitions. For example, Poland, one of the transition leaders in ECA, implemented early on numerous reforms to strengthen the financial sector's institutional capacity—including developing prudential and supervisory regulation, passing a new securities law, and revising national accounting standards—before gradually privatizing the state-owned banks. By contrast, Russia pursued privatization while leaving many financial market infrastructure gaps unfilled (such as ensuring the well-functioning of independent share registries). In addition, a surge in banking activity ahead of regulatory and supervisory capacity generated a lower subsequent credit growth compared to peers. Experience also shows that adequate capitalization of SOCBs is paramount to improve performance in the post-privatization period.

99. **Any necessary transformation to maximize the franchise value of the SOCBs slated for privatization will be carried out to achieve successful privatization outcomes**. Component 1 will support the transformation of SOCBs not already addressed by other IFIs, including through targeted upgrading their ICT systems, changes in the credit risk management framework, and digitalization of bank processes. This will maximize the value of the transaction for the government and foster the engagement of the private sector.

100. **The project support to disaster risk finance and insurance market development is expected to generate substantial benefits that are likely to significantly outweigh the project costs.** Component 2 is expected to: (i) improve financial planning for disasters and potentially increase the availability of funds, (ii) improve cost-effectiveness of using public money after disasters by putting in place a pre-arranged DRF instrument instead of relying on ex-post domestic public finance (such as budget reallocations), (iii) mainstream disaster resilience into fiscal risk management and budget planning, and (iv) mobilize private sector financing for disaster response. In terms of expected costs, these include the development of DRF strategy, development of policies and regulations for the insurance sector and capacity-building of the regulator, and subsequent money put into the design, development, and implementation of a DRF instrument.

101. **Rapid response to disasters and mobilizing insurance sector financing will generate significant benefits**. For example, it was estimated that uninsured disasters can slow down economic growth by an average of 0.6 – 1 percent and

[52] De la Torre, A., Gozzi, J. C., & Schumukler, S. L. (2017). Innovative Experiences in Access to Finance: Market-Friendly Roles for the Visible Hand?. Washington, DC: World Bank.
[53] Cull, R., & Spreng, C. P. (2011). Pursuing efficiency while maintaining outreach: Bank privatization in Tanzania. Journal of Development Economics, 94(2), 254-261.
Estrin and Pelletier, 2018

cause cumulative output loss of two to three times this magnitude.[54] With increased spending from the public budgets, disasters can trigger budget volatility and worsen a country's fiscal stance, especially when limited risk transfer is available.

Maximizing Finance for Development and MFD-enabling effect of the project

102. **Through its support of SOCB privatization, the proposed project can enable private sector investments of about US$300 million under a weighted-average scenario.** The high uncertainty surrounding the economic and geopolitical impacts from the Russian-Ukraine conflict warrants an analysis of the expected private capital enabled based on alternative scenarios. As one key assumption, the scenarios build on the planned list of SOCB privatizations during the lifespan of the project—as per the relevant PDO-level indicator that corresponds to the government commitments in the Bank Sector Reform Strategy. Other key assumptions include:

- the share of equity stake expected to be privatized (from pessimistic 51, to baseline 60 percent, to optimistic 75 percent), and
- the price to book (P/B) value expected to be paid—considering the current SOCB's reported problem loans (net of created provisions) and outstanding loans to SOEs which may get heavily discounted—we assume at 30 percent on the dollar. The resulting price to book value is assumed to vary by minus/plus 30 percentage point in the pessimistic/optimistic scenarios—the latter is capped at 100 percent.

To arrive at a weighted average across the three scenarios, we weigh the optimistic, baseline, and pessimistic scenarios by 10 percent, 30 percent, and 60 percent. This weighted-average scenario estimates the private capital enabled from SOCB privatization at about US$300 million. If conditions deteriorate, including due to more adverse repercussions from the Russian-Ukraine conflict, the "pessimistic" scenario estimates the private capital enabled at about US$150 million. The assessment was done based on bank level data as of end 2021, using a static analysis.

Poverty and Social Impact

103. **The proposed project will have a positive poverty and social impact through increased access and use of financial instruments and better-quality financial services**. A more efficient, dynamic banking sector improves the allocation of resources toward the most productive projects with positive spillovers for employment and aggregate productivity. Improvements in firm productivity would ultimately raise the income per capita. Furthermore, a diverse banking system will allow offering of financial tools more fitted to the needs of the low-income population. Component 3 will help enhance the trade and export financing instruments to export-oriented MSMEs. Moreover, a lower involvement of the government in the banking sector would lead to a lower fiscal burden of underperforming banks on public finances. Fiscal revenues from privatization and disinvestment can be used to reduce fiscal debt or be redeployed in value-added projects (e.g., infrastructure) to enhance growth potential and reach and quality of public services. Refocusing SOCBs with double-bottom line on well-defined socio-economic objectives is expected to improve access to finance, including in rural areas.

104. **Financial planning for disasters will help mitigate their impact on the most vulnerable people.** Disasters can threaten efforts to reduce poverty and build shared prosperity. The poor and vulnerable people are disproportionally affected by disasters because they have less assets and savings to rely on. Disasters can push people back into poverty or lead to poverty traps. For poor households, early relief can reduce the need to resort to negative coping strategies which have been shown to have detrimental long-term consequences. Early intervention and provision of disaster recovery will

[54] Von Peter, G., S. von Dahlen, and S. Saxena. 2012. "Unmitigated Disasters? New Evidence on the Macroeconomic Cost of Natural Catastrophes." BIS Working Paper 394, Bank for International Settlements. https://www.bis.org/publ/work394.pdf

decrease secondary impacts of disasters. Mobilizing insurance sector to disaster risk financing will allow to reduce the post-disaster funding gap and increase post-disaster funding significantly, underwrite loss at a scale not feasible for donors and governments, and speed up economic recovery. Component 2 will pay specific attention to finding DRF instruments suitable for different income levels.

B. Fiduciary

(i) Financial Management

105. **The Ministry of Finance will be the Implementing Agency (IA) for the project.** The assessment of the MOF's financial management arrangements has showed that the FM arrangements at the IA are acceptable and are assessed as "***Moderate***" considering the existing capacity (experience, resources, mandate, etc.) of the MOF, including the gained experience and capacity from implementing the ICB. The PIU under MOF, which is responsible for the implementation of the ICB and COVID-19 (the Emergency COVID-19 Response project – P173827) projects, is duly staffed, resourced, and experienced. The assessment has found that the capacity and level of the PIU staffing, existing accounting software, capacity to arrange and maintain the acceptable funds flow arrangements, planning and budgeting process, financial accounting and reporting, internal controls and audit arrangements are acceptable. The PIU will expand the FM staffing level to the extent necessary to ensure due FM arrangement throughout the project implementation.

106. **The FM requirements throughout the project implementation will include:** (i) ensuring adequate FM resources within the PIU; (ii) maintaining adequate internal controls procedures and environment, which will be reflected in the Project Operations Manual (effectiveness condition); (iii) ensuring that the project will follow transaction-based disbursements in line with the Bank's disbursement guidelines, (iv) submission of quarterly unaudited Interim Financial Reports (IFRs) to the World Bank; (v) conducting annual external audit of the project financial statements by an independent private auditor on the terms of reference acceptable to the World Bank; and, (vi) ensuring that the PIU updates the existing accounting software to account for project funds flows, transactions, and reporting.

(ii) Procurement

107. **Applicable Procurement Framework.** All procurement of contracts will be conducted through the procedures as specified in the World Bank's Procurement Regulations for IPF Recipients - Procurement in Investment Project Financing Goods, Works, Non-Consulting and Consulting Services, dated November 2020. The Guidelines on Preventing and Combating Fraud and Corruption in projects financed by IBRD loans and IDA credits and Grants, dated October 15, 2006, and revised July 1, 2016, shall apply to this project. The procurement and contract management processes will be tracked through the Systematic Tracking of Exchange in Procurement (STEP) system.

108. **Project Procurement Strategy for Development (PPSD).** The PPSD was prepared by the PIU under the MoF. It includes the following key deliverables: (i) a summary of which packages are to be put to market; (ii) a summary of risks and opportunities to be managed; (iii) options for contracting approaches; and (iv) a separate section on procurement arrangements for optimization of internal approval processes. Based on the PPSD, the PIU has prepared the Procurement Plan (PP) which covers the entire period of project implementation. The PP includes eight key procurement packages, major large-value TA packages of which include: (i) Undertaking diagnostic and other consultancy services directly to the SOCBs; (ii) consultancy support to MOF to effectively implement its SOCB oversight function, and (iii) TA for the Banking and Finance Academy - trainings in the financial sector. The PP will be updated at least annually or as required during

project implementation to reflect any substantial changes in procurement approaches and methods to meet actual project implementation needs, market fluctuations, and improvements in institutional capacity. The updated PPs along with the revised PPSD (if required) will be subject to WB's prior review and no objection.

109. **Procurement risk assessment.** The WB task team has conducted a procurement capacity assessment using the Procurement Risk Assessment and Management System (P-RAMS). Based on the assessment and taking note of the existing capacity within the IA and the risks associated with procuring a number of technical assistance activities, the procurement risk is assessed as ***"Substantial"***. Risks identified in the procurement assessment of the IA/PIU include: (i) issues with the enforcement of the Public Procurement Law (PPL) and other relevant legislative requirements in practice; (ii) possibility of an attempt of influence by government officials on procurement decisions; (iii) difficulties in hiring qualified national procurement consultants due to the low salary levels; and (iv) procurement delays, specifically in preparation of the technical specifications/terms of references. To mitigate these risks, the following actions are recommended: (a) all procurement activities will be carried out following World Bank procurement procedures, including the related prior- or ex-post reviews; (b) the World Bank team will support the PIU staff on all procurement matters to ensure that procurement processes are carried out in line with relevant World Bank policies and procedures; (c) the PIU will ensure that an additional qualified procurement staff is hired as needed to be responsible for the day-to-day procurement activities; (d) the World Bank good governance and anticorruption safeguards, particularly the transparency and disclosure provisions of the IBRD Guidelines, will be promoted and enforced; (e) the PPSD will include a section reflecting the roles and responsibilities, including roles of consultant/experts, for development of good quality TORs and Technical specifications. In addition, the role of the IA and other involved agencies in designing technical specifications and TORs will be clarified; (f) POM should have clear deadlines and timelines for each step in the procurement processes for both consultant selection and goods/technical services procurement to avoid unnecessary delays during the implementation.

110. **Use of national procurement procedures.** All contracts for goods and consultancy services following national market approach shall use the procedures set out in the Public Procurement Law (PPL) enforced in June 2021. The provisions of the PPL are consistent with the WB Procurement Regulations Section V – Para 5.4 National Procurement Procedures subject to a few conditions specified in PPSD. Further improvement of the 2021 legal and regulatory framework is being carried out by GOU. The ongoing reform activities include the development of a full-fledged e-procurement system. The World Bank will update the assessment of the National Procurement Procedures after introduction of a full-fledged e-procurement system that will be adopted for the national competition procurement approach under the project.

C. Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

D. Environmental and Social

111. **The project's environmental and social risks are rated Moderate.** The following ESSs are relevant: ESS 1, ESS 2, ESS 3, ESS 4 and ESS10. The interventions are expected to result mostly in positive impacts as it would lead to: (i) enhanced

corporate governance and risk management of SOCBs; (ii) transformation of SOCB business models and operations from the previous “state-agent” role to a new competitive banking role; (iii) refocusing the SOCBs remaining toward well-defined market “gap-filling” and ensure financial inclusion and access so as to better serve the needs of the hitherto deprived segments such as low-income household, rural populations, micro and small firms; and (iv) enhance the capacity of disaster risk financing. The interventions are exclusively “software” oriented encompassing policy changes, capacity building and capacity support. No new civil/large scale construction works impacting the environment are envisaged. The detailed scope of modernizing ICT infrastructures (Component 1.3) will vary depending on participating SOCBs, the activities will be limited to upgrading ICT equipment and relevant software installation related to the banking systems and confined to the existing facility footprint. This might create issues such as small rehabilitation and disposal/recycling of electronic waste when equipment is replaced. These will be mitigated through an Electronic Waste Management Plan and an Environmental and Social Management Plan (ESMF) checklist.

112. **On the social front, two issues assume significance–the pace of reforms and outreach**. The former would depend upon the overall country’s political economy and governance as well as the institutional capacity. The latter falls under the purview of the project and planned efforts are essential to ensure that it reaches out and engages systematically in reaching out to the stakeholders, particularly, and to the country, at large. This will not only help in keeping the country informed but also avoid any misunderstandings and mis-information campaigns creating reputational risks. The efforts of citizen engagement and timely information disclosure will be guided by the project Stakeholder engagement plan (SEP) and further complemented by the project dedicated GRM system which will serve as a two-way communication bridge.

113. **The project will primarily finance technical advisory, purchase of IT systems (software and hardware), training and workshops.** The project location is primarily Tashkent, the capital city. The project activities are not expected to trigger safeguard policies. Accordingly, the project team does not plan to prepare any safeguard-related studies.

114. **The proposed activities under the three project components are environmentally benign**. The project does not finance any new construction, rehabilitation, or renovation of existing infrastructure.

115. **Towards addressing the environmental and social risks and ensuring implementation in compliance with the relevant ESSs, the following documents have been prepared**: (i) Environmental and Social Commitment Plan (ESCP); (ii) Stakeholder Engagement Plan (SEP); (iii) Labor Management Procedures (LMP) and (iv) Electronic waste management plan; and (v) Environmental and Social management framework checklist (ESMF checklist). In compliance with the World Bank’s Environmental and Social Management Framework, the MoF prepared and disclosed the ESCP, SEP, LMP, ESMF checklist and the Electronic-waste Management Plan on the MoF official website on March 18, 2022 and April 6, 2022, and held public consultations on March 25, 2022. All of these documents, together with the ESRS, were disclosed on the World Bank’s website on March 11, 2022 and April 18, 2022.

V. GRIEVANCE REDRESS SERVICES

116. Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit

complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service.For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VI. KEY RISKS

117. **Overall risk-rating of the proposed project: Substantial**. The main risks that impact the achievement of the PDO relate to: (i) Political and Governance; (ii) Sector Strategies and Policies; and (iii) Institutional Capacity for Implementation and Sustainability.

118. **Political and Governance: Substantial**. The political environment has supported reforms under the new administration, and there is a strong commitment to continue the momentum both in general and specifically in the financial sector. Nevertheless, the approval process of the banking reform strategy was accompanied by some disagreements on several key aspects among various ministries and state agencies. While the government has approved the banking sector reform strategy and has built consensus, there is a risk that those disagreements may reemerge during the implementation phase of the strategy. Risks may arise from potentially poor coordination among various ministries and agencies directly and indirectly involved in the SOCB restructuring and privatization processes. There might be organic tendency to hold on to existing SOCBs, continue with directed/preferential lending practices to support priority sectors and SOEs, and/ or exert efforts to privatize SOCBs via non-transparent processes. To some extent, the risk is mitigated through concentrating the ownership and bank restructuring/ privatization functions in the MoF. However, apart from MOF, UFRD, SAMA and MIFT may have roles to play in the privatization of state banks and these roles need to be formally clarified for the benefit of stakeholders and prospective investors.

119. A further risk is associated with the SOCB privatization process not meeting the minimum expected standards in terms of transparency and openness to all qualified bidders, despite the commitment laid out in the Banking Sector Reform Strategy. This risk can be partially mitigated by engagement of reputable transaction advisors under the Project, as well as intensive supervision by WB team, including through the review of tender documentation to ensure quality and transparency.

120. **Sector Strategies and Policies: Substantial**. Substantial risks to the PDO stem from the complex challenges of navigating the reform agenda focused on bank restructuring and privatization for several state banks. The reform agenda touches upon such sensitive and soft issues as improving corporate governance in banks, separating the state ownership function from the policy-making/supervisory function, minimizing the scope of political interference, as well as withdrawing from the previous practices of on-lending, preferential lending, and state capitalization of SOCBs, among others. The nexus between the financial sector and SOEs also means that the success of banking sector reform will ultimately depend on progress with the SOE reform. These challenges are complex and cannot be implemented overnight. To date, the political decisions on the reform agenda and the authorities themselves have confirmed a strong commitment to implementation. However, the risks of backtracking or holding off the reform along the implementation path by various ministries, state agencies, SOEs (with vested interests), or even SOCBs themselves remain substantial. This will require careful, persistent, and coordinated transition led by the MoF as the single center point of the government's efforts on SOCB restructuring and privatization. Therefore, ensuring adequate resources and capacity at the MoF and its SOCB Reforms Department will be vital, and the proposed project will also contribute to the Department's strengthening. The risk of having proper institutional capacity at the MOF to conduct procurement of numerous complex contracts for transaction advisors and ICT package for SOCBs in accordance with the WB rules will also be critical.

121. Finally, reforms in the rest of the financial sector should keep pace with those in the banking sector. While the banking sector has gradually started transformation, the rest of the financial sector has not been subjected to the reform process to the same extent. Insurance penetration is very low, regulation and supervision of the sector needs significant enhancements. The new regulatory authority established under the MOF–IMDA, has a dual mandate of both development and supervision of the sector and currently does not have adequate capacity and resources to fulfill this mandate. The proposed project will provide capacity building support to IMDA.

122. The conflict in Ukraine may trigger known and unknown financial sector risks and disrupt reform efforts in Uzbekistan, including due to possibly necessary emergency support measures and regulatory forbearance. The assessed direct exposures are low to moderate, and the CBU is working on crisis preparedness and contingency response measures. The project team will continue monitoring the developments in the financial sector and update the risk rating during the appraisal.

123. **Institutional Capacity and Sustainability: Substantial**. The proposed reforms represent a substantial institutional shift and require sustained efforts to deliver results. The MoF is experienced in implementing several World Bank projects over the last few years, but not in the financial sector. Reforms outlined in the banking sector reform strategy have a far greater degree of complexity (especially in terms of implementation) and would require close coordination among stakeholders and significant institutional capacity building at both the government level (e.g., MoF Banking Reforms Department) and the SOCB level. As mitigating factors, the project will support the institutional strengthening of the MoF Banking Reforms Department. In parallel, most SOCBs' restructuring, and transformation will be supported by IFIs and reputable consulting firms.

124. Another risk is related with having a proper institutional capacity to conduct procurement of numerous complex contracts for transaction advisors and ICT package for SOCBs in accordance with the WB rules. The World Bank team will provide the needed support to the PIU to mitigate this risk.

125. **Stakeholder risk: Substantial**: It is expected that there might be significant resistance to change by management and staff of SOCBs with respect to SOCB transformation and privatization. This could be further reinforced by social resistance with respect to potential job losses from SOCB transformation and privatization, and risks of backtracking or holding off the reform along the implementation path by various ministries and state agencies, as mentioned above. Mitigation measures would include strengthening of MOF oversight role over bank transformation and privatization procedures (Component 1), improvement of corporate governance practices in SOCBs (including via installing majority independent Board members and Board chairman, transparent and competitive selection of CEOs and key managers of SOCBs), deployment of adequate change management and proactive communication strategies for SOCB restructuring and privatization. With respect to SOCB restructuring and privatization, the project would adopt good practices in structuring deals to manage the impact on jobs. This is a reputational concern for the Bank and will be monitored closely during implementation.

126. **Other – Reputational: Substantial.** The project presents a substantial reputational risk for the Bank due to the risk of replicating failures from attempts at similar reforms in other transition countries, especially the risk of non-transparent privatizations, not sound operations of a development bank and subsequent reputational repercussions for the World Bank. To mitigate these risks, the project will pay careful attention to lessons learned in other TA projects, especially on SOE and SOCB reforms from other transition countries. In addition, the Task Team will provide quality and timely hands-on support to the PIU while supervising the project implementation.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework
COUNTRY: Uzbekistan
Uzbekistan Financial Sector Reform Project

Project Development Objectives(s)

The project development objective is to support the authorities in restructuring and/or privatizing state-owned banks, increasing financial resilience to disasters, and expanding finance for exporting MSMEs.

Project Development Objective Indicators

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
SOCBs restructured and privatized							
Number of SOCBs privatized (with more than 50% of shares divested) (Number)		0.00	0.00	1.00	3.00	4.00	5.00
Number of SOCBs slated to remain in state ownership, in which majority of Board members—including Board Chairman—are independent (Text)		0.00	0.00	1.00	All SOCBs slated to remain in public ownership.	All SOCBs slated to remain in public ownership.	All SOCBs slated to remain in public ownership.
Financial resilience to disasters increased							
Government's funding gap regarding disaster risk financing reduced according to the adopted disaster risk		100% funding gap					Funding gap reduced per risk appetite reflected in the adopted DRF strategy

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
financing strategy thanks to newly introduced policies/instrument(s) (Text)							
Finance for exporting MSMEs expanded							
Beneficiaries reached with financial services (CRI, Number)		200.00	500.00	800.00	1,400.00	1,800.00	2,000.00
Businesses that benefited from financial services (CRI, Number)		200.00	500.00	800.00	1,400.00	1,800.00	2,000.00

Intermediate Results Indicators by Components

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Component 1: State-owned banks modernization, commercialization, and privatization							
MOF Banking Reform Department adequately staffed (Number)		5.00	8.00	10.00	11.00	11.00	11.00
MOF Banking Reform department's core policies and regulations adopted (Text)		- MOF Banking Reform department's core policies and regulations are not adopted - Annual report on the state banking sector not published	- SOCB Department/Unit internal regulation adopted - SOCB Ownership policy developed - SOCB privatization sequence reviewed and revised	- Social objectives for SOCB remaining in state ownership adopted - SOCB privatization sequence reviewed and revised - Annual report on the state banking sector	- SOCB privatization sequence reviewed and revised - KPIs and targets for all SOCBs reviewed and revised - Annual report on the state banking sector		- MOF Banking Reform department's core policies and regulations are adopted - SOCB privatization sequence reviewed and revised

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
			- Screening criteria for SOCB potential strategic investors - SOCB Board member/Executive Management appointment and compensation procedure (rules) adopted - MOF and SOCB interaction procedure adopted - M&E system for assessment of performance of SOCBs developed, KPIs for all SOCBs developed - Procedural guidance on SOCB privatization developed - SOCB restructuring and privatization communication/awareness program adopted - Annual report on the state banking sector published	published	published		
MOF Banking Reform Department staff trained (Number)		0.00	4.00	5.00	6.00	11.00	11.00
Specialists trained by the Banking and Finance Academy		0.00	0.00	400.00	900.00	1,300.00	1,500.00

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
(Number)							
Share of female specialists trained by the Banking and Finance Academy (Percentage)		0.00	0.00	30.00	40.00	45.00	50.00
Number of Trainers Trained by the Banking and Finance Academy (Number)		0.00	0.00	20.00	40.00	60.00	70.00
Number of SOCBs where majority members of the Executive Management have completed the executive training (Text)		0.00					All SOCBs slated to remain in public ownership.
Number of SOCBs formally offered for privatization (Number)		3.00	4.00	5.00	6.00	7.00	7.00
Number of SOCBs slated to remain under public ownership and have met the majority transformation KPIs and targets set by the MOF (Number)		0.00	0.00	0.00	0.00	2.00	4.00
Share of SOCBs with at least 15 percent of women on the Board (Percentage)		17.00	17.00	25.00	35.00	45.00	50.00
Share of SOCBs with at least 15 percent of women on the Executive Management (Percentage)		17.00	17.00	25.00	35.00	45.00	50.00
Share of preferential loans in total credit portfolio of SOCBS (Percentage)		44.00	40.00	36.00	32.00	28.00	24.00
Overall satisfaction with citizen		0.00	30.00	40.00	50.00	60.00	70.00

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
engagement process (Percentage)							
Component 2: Financial preparedness to disasters and strengthening insurance sector stability							
Disaster Risk Financing strategy adopted (Yes/No)		No	No	Yes	Yes	Yes	Yes
A feasibility study to identify DRF instruments is developed (Yes/No)		No	No	No	Yes	Yes	Yes
A risk financing instrument, such as a reserve fund or centralized insurance pool established (Yes/No)		No	No	No	No	Yes	Yes
Share of women in executive management of a reserve fund or centralized insurance pool (Percentage)		0.00	0.00	0.00	0.00	25.00	25.00
Risk Based Supervisory Framework for non-life insurance sector has been adopted (Yes/No)		No	No	Yes	Yes	Yes	Yes
Improved regulation on solvency regime for life and non-life insurance companies adopted (Yes/No)		No	No	Yes	Yes	Yes	Yes
IMDA insurance supervision staff trained (Percentage)		0.00	0.00	30.00	40.00	50.00	60.00
Component 3: Development Bank, export and import financing instruments							
Number of new or improved export and trade financing instruments operationalized (Text)		1.00					3.00

Indicator Name	PBC	Baseline	Intermediate Targets				End Target
			1	2	3	4	
Development Bank of Uzbekistan established (Yes/No)		No					Yes

Monitoring & Evaluation Plan: PDO Indicators					
Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Number of SOCBs privatized (with more than 50% of shares divested)	Refers to the cumulative number of state-owned banks, more than 50 percent of the equity of which is sold to non Uzbek government investors under the project. At least three of those SOCBs should be privatized to strategic investors as per the Banking Reform Strategy.	Annual	MOF, CBU, SAMA, State Registry on legal entities	Progress report on SOCB privatization transactions, data from Registry on legal entities	MOF, CBU, SAMA
Number of SOCBs slated to remain in state ownership, in which majority of Board members—including Board Chairman—are independent	Refers to the cumulative number of state-owned banks slated to remain in state ownership, and which remain compliant with the requirement that majority number of Board members,	Annual	CBU	Report on the number and status of independence of all Board members of the state-owned banks	CBU

	including Board Chairman are independent and qualified by the CBU. The term "independent" will be defined in the POM.				
Government's funding gap regarding disaster risk financing reduced according to the adopted disaster risk financing strategy thanks to newly introduced policies/instrument(s)	Refers to the difference between the financing available and needed for major events. Either a certain return period or annual average loss will be determined based on World Bank catastrophe model for Uzbekistan.	One-time by end of project	World Bank cat model on disaster losses, and budget and other fiscal data (size of reserve fund), AXCO report and IMDA data on insurance penetration, size of new instruments or role of policies in reducing government contingent liabilities	Fixed funding gap size; data collected on new risk financing instruments (e.g. US$ allocated to reserve fund, insurance policies, reinsurance arrangements to prevent risk of insolvency and other indicators)	MOF, IMDA
Beneficiaries reached with financial services	The indicator measures the number of persons benefited from financial services in operations supported by the Bank, and	Annual	Refers to the cumulative number of exporting MSMEs,	Report on the volume and outstanding amount of export and trade finance instruments provided	MIFT, EPA, EsuF, CBU

	the number of businesses that benefited from financial services.		which have been financed by banks with support of the export and trade finance instruments offered by ESuF or development bank of Uzbekistan under the project. Com mercial banks, EPA, ESuF, MIFT	by banks	
Businesses that benefited from financial services	Number of businesses reached with financial services in operations supported by the Bank. Beneficiaries include microenterprises, SMEs, and large business. Financial services include transaction accounts, deposit accounts, mobile money accounts, loans, insurance, pension, factoring, leasing, bonds,	Annual	Refers to the cumulative number of exporting MSMEs, which have been financed by banks with support of the export and trade	Report on the volume and outstanding amount of export and trade finance instruments provided by banks	MIFT, EPA, EsuF, CBU

	etc.		finance instruments offered by ESuF or development bank of Uzbekistan under the project. Com mercial banks, EPA, ESuF, MIFT		

Monitoring & Evaluation Plan: Intermediate Results Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
MOF Banking Reform Department adequately staffed	Number of FTEs of the MOF Banking Reform Department	Annual	MOF	MOF Human resources administrative data report	MOF HR Department
MOF Banking Reform department's core policies and regulations adopted	Refers to the select internal core policies adopted by the MOF	Annual	MOF	MOF progress report, resolutions confirming the adoption of the select internal policies	MOF Banking Reforms Department
MOF Banking Reform Department staff trained	Refers to cumulative number of staff of MoF Banking Reforms Department trained on on	Annual	MOF	Training attendance reports	MOF HR Department, Banking Reform Department

	corporate governance, privatization and PPP structuring and risk management				
Specialists trained by the Banking and Finance Academy	Refers to the cumulative number of specialists trained by the Banking and Finance Academy on the topics supported by the Project (both physically and online).	Annual	Banking and Finance Academy	Training attendance reports	Banking and Finance Academy
Share of female specialists trained by the Banking and Finance Academy	Refers to the share of female specialists in the total number (flow) of specialists trained by the Banking and Finance Academy in each year on the topics supported by the Project.	Annual	Banking and Finance Academy	Training attendance reports	Banking and Finance Academy
Number of Trainers Trained by the Banking and Finance Academy	Refers to the cumulative number of Trainers Trained by the Banking and Finance Academy supported by the Project.	Annual	Banking and Finance Academy	Training attendance reports	Banking and Finance Academy
Number of SOCBs where majority members of the Executive Management have completed the executive training	Refers to the total cumulative number of SOCBs majority members of the Executive Management of which have completed the executive training offered by the Banking and Finance Academy developed	Annual	Banking and Finance Academy	Training attendance reports	Banking and Finance Academy

	by the project				
Number of SOCBs formally offered for privatization	Refers to the cumulative number of SOCBs which were prepared and formally offered for privatization through tenders or bilateral negotiations under the project	Annual	MOF, SAMA	Report on privatization progress	MOF, SAMA
Number of SOCBs slated to remain under public ownership and have met the majority transformation KPIs and targets set by the MOF	Refers to the cumulative number of SOCBs slated to remain under public ownership and have met the majority of the KPIs set by the MOF (i.e. >60% of the total number of KPIs)	Annual	MOF, CBU	Report on SOCBs transformation progress	MOF Banking Reforms Department
Share of SOCBs with at least 15 percent of women on the Board	Refers to the share of number of SOCBs with at least 15 percent of women on the Board in the total number of SOCBs	Annual	CBU	Report on the total number and gender disaggregation of all Board members of the state-owned banks	CBU
Share of SOCBs with at least 15 percent of women on the Executive Management	Refers to the share of number of SOCBs with at least 15 percent of women on the Executive Management in the total number of SOCBs	Annual	CBU	Report on the total number and gender disaggregation of all SOCB executive management members	CBU
Share of preferential loans in total credit portfolio of SOCBS	Refers to the share of total outstanding preferential loans provided by SOCBs in the total outstanding	Annual	CBU	Statistical information on loan portfolio breakdown	CBU

	amount of SOCB credit portfolio. The term "preferential loan" shall be used in accordance with the definition developed/improved by the CBU both for LC and FX loans.				
Overall satisfaction with citizen engagement process	Percentage of citizens/ MSMEs who report that the project has established effective citizen engagement processes (through the feedback mechanism, surveys, roundtables and consultations)	Annual	MOF	Progress reports and survey results	PIU
Disaster Risk Financing strategy adopted	Refers to the Disaster Risk Financing Strategy adopted by a Presidential Decree or other government decree	Annual	MOF, Government website	Monitoring Government website and interview with MOF	MOF/PIU
A feasibility study to identify DRF instruments is developed	Refers to the feasibility study developed and finalized for a DRF instrument as provided in the DRF strategy implementation plan	Annual	MOF, Government website	Interview with MOF, feasibility study authors and the report on feasibility study	MOF/PIU
A risk financing instrument, such as a reserve fund or centralized insurance pool established	Refers to the adopted Presidential or governmental resolution/law on	Annual	MOF, Government website	Monitoring Government website and interview with MOF	MOF/PIU

	establishment, objectives, scope, implementation modalities and regulation and supervision of the reserve fund/insurance pool				
Share of women in executive management of a reserve fund or centralized insurance pool	Refers to the share of total number of appointed female executive management members in total number of all members of Executive Management of the established reserve fund or centralized insurance pool	Annual	MOF, reserve fund or centralized insurance pool regulatory agency, reserve fund or centralized insurance pool website	Data on all members of Executive Management of the established reserve fund or centralized insurance pool	PIU
Risk Based Supervisory Framework for non-life insurance sector has been adopted	Refers to internal manual on risk-based supervision framework for non-life insurance companies adopted by the IMDA Management that addresses/integrates the material risks including climate change related risks into supervisory framework/tools	Annual	IMDA	IMDA internal resolution to adopt the manual on risk based supervisory framework	IMDA
Improved regulation on solvency regime for life and non-life insurance companies adopted	Refers to external regulation on solvency regime for life and non-life insurance	Annual	Government website, IMDA	Monitoring Government website and interview with	IMDA

	companies adopted by the IMDA Management			IMDA	
IMDA insurance supervision staff trained	Refers to cumulative number of IMDA staff trained on on-site and off-site insurance supervisory practices, consistent with the IAIS Insurance Core Principles (monitored by gender).	Annual	IMDA	Training attendance reports	IMDA
Number of new or improved export and trade financing instruments operationalized	Refers to the number of new or improved export and trade financing instruments developed and rolled out by EPA/EsuF/Development Bank of Uzbekistan under the project	Annual	EPA, ESuF, commercial banks	Progress report on introduction and utilization of new or improved export and trade financing instruments	MIFT/EPA/ESuF
Development Bank of Uzbekistan established	Refers to the adopted law, Presidential or governmental resolution on establishment, objectives, scope, implementation modalities and regulation and supervision of the Development Bank of Uzbekistan.	Annual	MIFT, MOF, Government website	Monitoring Government website and interviews with MIFT and MOF	MIFT, MOF and PIU

ANNEX 1: Implementation Arrangements and Support Plan

COUNTRY: Uzbekistan
Uzbekistan Financial Sector Reform Project

1. **The overall implementing agency for the project will be the MoF, the First Deputy Minister of Finance – assisted by the head of MOF Banking Reforms Department – will oversee the project implementation.** The First Deputy Minister of Finance will strategically oversee project implementation, monitor progress, and ensure overall project alignment with stated objectives and results. The First Deputy Minister of Finance will act as a focal point for communication with the World Bank team on project-related issues. The MOF Banking Reforms Department will support the First Deputy Minister of Finance in implementing the day-to-day project implementation.

2. **The First Deputy Minister of Finance will be supported by the PIU Director who will oversee the PIU**. The PIU is already established under the ongoing Institutional Capacity Building (ICB) project (P168180), and will be also ultimately responsible for fiduciary, environmental and social management, M&E, reporting, managerial and other administration responsibilities over project implementation. The current staffing capacity of the PIU will be expanded as needed to ensure effective implementation of the project, and more specifically the PIU should hire a project coordinator and an environmental and social specialist. Where needed, the PIU will be supported by the MOF Banking Reforms Department and the consultants hired to support this department, as well as other expert consultants (e.g. with regard to ICT modernization related procurements), to help develop clear and well-drafted ToRs which require high level of technical specialization. Any critical changes to the PIU organizational structure, mandate and authority shall be pre-agreed with the World Bank.

3. **Corresponding lead agencies will provide technical oversight for each component.** Component 1 and 2 will be technically led by the MoF, and Component 3 will be technically led by MIFT. Under each component, sub-components may have beneficiary agencies different from the component leads. For example, beneficiary agencies of Component 1 will be SAMA, the Banking and Finance Academy and CBU (with regard to the training program), for Component 2 – the IMDA, and for Component 3 – EPA and ESuF (see Table 5). Each of these beneficiary agencies will nominate a key focal point no later than three months after the project effectiveness. Inter-agency working groups will be established, as necessary, to ensure close coordination and ownership at the operational and technical levels.

Table 5. Project Management Responsibilities[55]

Component/Project Management Areas	Component 1	Component 2	Component 3
Overall Project Management/Oversight, Component Implementation, Coordination and M&E	MOF		
Component Technical Oversight	MOF	MOF	MIFT
Fiduciary (Procurement process/ Financial Management,	MOF through its PIU		

[55] Allocation of the functional responsibilities among the state agencies can be adjusted as per changes or amendments in the government structure.

Environmental and Social management)			
Technical coordination of developing TORs, managing consultants, validating and accepting the results and deliverables under the ToRs/consultancy contracts	MOF, Banking and Finance Academy, SAMA, CBU	MOF, IMDA	MIFT, EPA, ESuF

4. **The PIU will be responsible for monitoring and reporting on implementation progress and results**. The PIU will report–on biannual basis– on implementation progress, results achieved and issues that impede progress and results to the MoF and the WB. The M&E function will use the project's Results Framework, and the progress will be made public on the World Bank's external website. In addition to the outcomes identified in the Results Framework, project progress will also be validated against external indicators, where applicable. The project will be subject to regular implementation support missions conducted by the World Bank. The progress assessed during these missions will be reported by the World Bank team to its management through the ISRs, which will include a review of key implementation issues and performance indicators. The results will be disclosed through the ISR on the World Bank's external website for the project. In the third year of project implementation, a midterm review will be conducted. The Results Framework may be revisited and updated during the midterm review. At the completion of the project, an ICR will be prepared.

Financial Management

5. **The adoption of the Project Operations Manual (POM) will be a condition for project effectiveness.** The POM will include the following information: (i) the detailed description of project implementation activities, their sequencing and the prospective timetable; (ii) the institutional arrangements and decision-making procedures for the implementation of the project; (iii) the project administrative, procurement, financial management and disbursement requirements and procedures, including the budgeting, planning, accounting, audit, the flow of relevant documents; (iv) the plan for the monitoring, evaluation and supervision of the project and the results indicators; and (v) plans for mainstreaming citizen engagement and gender considerations into the project.

6. **Staffing.** The PIU is well staffed, and consists of the PIU Director, FM specialist, Procurement Specialist and other specialists. For the proposed project, the PIU will rely on the existing human resources and will be attracting additional human resources based on the needs.

7. **Budgeting and Flow of Funds**. The PIU will prepare an annual budget based on procurement plans, operating expenses estimations, etc., and will submit it to MOF for approval. The PIU Director and the FM Specialist will be responsible for the Project budget planning, preparation, execution, monitoring and reporting procedures. These will include monthly/quarterly planning and the preparation of annual budgets. The budget will form the basis for allocating the funds as per project activities and project periods. The Project agreed budget will be the basis for the PIU to use funds from PIU designated account.

8. **Accounting.** The PIU will be in charge of keeping accounting records for this project and will keep its accounting records in the existing accounting system. The PIU will need to upgrade the existing software (or install additional module) to address the needs of additional project financial and accounting management needs. The project accounting records will be maintained in accordance with the International Public Sector Accounting Standards (IPSAS, cash basis). At the same time, the PIU may apply local accounting standards for statutory financial and accounting management and reporting purposes to report on project to state agencies. This system shall allow fully automated accounting and reporting, including automatic generation of Statements of Expenditure, Interim un-audited financial reports (IFRs), and other reports required by national legislation. The system shall have in-built controls to ensure data security, integrity,

and reliability. The financial reports will be accounted and reported in the currency of credit proceeds for World Bank reporting requirements, and in the local currency for the local authorities and statutory reporting purposes.

9. Financial reporting. The PIU under MOF will be preparing and submitting to the World Bank the Interim Un-audited Financial Reports (IFR) on quarterly basis within 45 days following the reporting calendar quarter starting with the quarter in which the first disbursement occurs. The format of IFRs will be agreed with the World Bank, will be annexed to the POM and will include (a) project sources and uses of funds, (b) uses of funds by project activities, (c) project balance sheet, (d) designated account (DA) statement, and (e) a statement of expenditure withdrawal schedule.

10. Internal Controls. The PIU under MOF will upgrade the internal controls system to address the proposed projects needs, transactions and etc., so that it is capable of providing reliable and adequate controls over financial management and disbursement processes and procedures. These include controls for safeguard of assets, segregation of duties, authorization of transactions, review and approval of invoices, and contract management, among others. The internal control system to be implemented and maintained by the PIU, including the budgeting, planning, financial reporting and accounting, and auditing requirements, will be thoroughly specified in the POM, which will be adopted by the STC in the form and substance acceptable to the World Bank.

11. External audit. The PIU under MOF will be responsible for arranging an independent annual audit of the project's financial statements. The audit of the project's financial statements will be conducted (a) by an independent private auditor firm acceptable to the World Bank, on terms of reference acceptable to the World Bank, and (b) according to the International Standards on Auditing issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The project audit will include (a) audit of financial statements and (b) review of the internal controls of the PIU with special attention to the compliance with requirements established in the Financing Agreement and World Bank guidelines and procedures and also the local legislation requirements. No entity audit will be required.

The audited project financial statements will be publicly disclosed in a manner acceptable to the World Bank. Following the World Bank's formal receipt of the statements from the borrower, the World Bank will make them available to the public in accordance with the World Bank Policy on Access to Information. Audit of project's financial statements will be financed from credit proceeds.

12. Disbursements and payments. The PIU will be in charge of planning, managing, and controlling the project disbursements and payments, as well as preparing and submitting withdrawal applications to the World Bank. For this purpose, the PIU will make use of existing access to the World Bank's Client Connection platform, granted under the ICB project. The project will use standard disbursement methods, including advances (DA), direct payments, reimbursements, and special commitments. The project funds will be disbursed to the Designated account (DA) to be opened at a financial institution *acceptable* to the World Bank. The detailed guidance on the DAs, DA maintenance and ceilings, costs allocations, and so on will be specified in the Disbursement and Financial Information Letter, which will be part of the Financing Agreement. The DA will not be pooled with other funds not related to the project, and all the payments from the DA will be executed by the PIU and the payments will be made for the eligible expenditures.. Eligible project expenditures would be documented to the World Bank using Statements of Expenditure (SOE) and copies of full documentation. For all expenditures disbursed on the basis of statements of expenditures, full documentation in support of the statements of expenditures will be retained in the PIU, according to local regulation requirements, but for not less than five years after the project's closing date. This information will be available for review by World Bank missions during project supervision and by the project audits.

13. FM supervision. The project will be supervised regularly using a risk-based approach that will review audit reports and IFRs and advise the task team on FM issues. The project will be supervised at least twice a year, including support missions during project implementation period. Mixed on-site supervision missions will be undertaken with World Bank colleagues specializing in procurement, M&E, and disbursement.

Procurement

14. Procurement arrangements. The PIU will be in charge of planning, managing, and conducting the project procurement activities in line with the PPSD and approved Procurement Plans. All procurement of activities shall be conducted through the procedures as specified in the World Bank's Procurement Regulations for IPF Borrowers: Procurement in Investment Project Financing Goods, Works, Non-Consulting, and Consulting Services, dated November 2020.

15. Staffing. The PIU will leverage on the existing Procurement Specialist to manage procurement requirements. Where needed, the PIU will ensure that an additional qualified procurement staff is hired to be responsible for the day-to-day procurement activities.

16. Procurement supervision and ex post review. Routine procurement reviews will be conducted by the procurement specialist based in the country office. In addition, two project implementation support missions are expected to take place per year, during which procurement ex-post reviews will be conducted for the contracts that are not subject to the World Bank's prior review on a sample basis (20 percent with regard to the number of contracts). One ex-post review report will be prepared per fiscal year, including findings of physical inspections for not less than 10 percent of the contracts awarded during the review period.

ANNEX 2: Detailed Project Description

COUNTRY: Uzbekistan
Uzbekistan Financial Sector Reform Project

Component 1: State-owned banks modernization, commercialization, and privatization (US$9.8 million)

1. **This component will support the implementation of the adopted banking sector reform strategy focusing on restructuring, transformation, and privatization of SOCBs**. The ultimate objective of the state is to rationalize its ownership in the banking sector to a point where the number, size, and reach of the SOCBs is commensurate with the policy objectives attached by the state to the banking sector, and support development of human resources for early and successful banking system transformation. This component will support this through the following sub-components: (i) consultancy support and institutional capacity building for MOF to support the ownership function over SOCBs, (ii) providing consultancies to select SOCBs to implement restructuring and prepare for privatization, (iii) financing investments in SOCB modernization and (iv) supporting the Banking and Finance Academy in raising the human resource capacities for the financial sector. Further details on sub-component activities are provided below.

2. **Sub-component 1.1: Consultancy support and institutional capacity building for MOF to support the ownership function across SOCBs (US$2.2 million)**. The ownership function for SOCBs and oversight over SOCB restructuring and privatization was centralized in the MoF under the Banking Reforms Department. This sub-component will provide support to the MOF in the following two main areas: (i) strengthen state ownership and oversight role over SOCBs, including via hiring several long-term international advisors, and (ii) provide transactions-oriented technical assistance.

3. **Strengthening the MOF's ownership and oversight function for SOCBs**. The project will support the following activities:

   a. **Support further operationalization of the MOF Banking Reforms Department**. This would entail the following activities: (i) clarify the status, role and objectives of the Banking Reforms Department within the MOF, ensure clear division of work among various units of the Department involved in dealing with SOCBs, review and reorganize the Department where needed; (ii) review and, to the extent possible, revise the salary scale of the Department staff to bring it close to that of the banking sector; (iii) establish the sequence and priorities of tasks of the Department on an annual basis, (iv) attract local and foreign professionals (staff, consultants) with necessary background and experience to effectively implement the activities outlined in the annual plans; and (v) develop and implement effective relations with SOCBs (including develop a communication policy) and sound understanding of role and level of intervention of the Department in bank transformation processes.

   b. **Develop a coherent and well-structured SOCB ownership policy and regulations**. This policy (regulations) should specify: (i) the state's objectives as an owner for SOCBs slated to remain in state ownership, (ii) the respective roles of the state, the board of directors, and management of SOCBs, and autonomy in SOCBs operations, where the government is removed from operational decision-making, (iii) revised approach to appointing Board members, considering nomination of professional supervisory boards based on merit-based, gender-balanced, transparent, and competitive, as well as adequate remuneration systems for SOCB Board members, (iv) the gap-filling roles for SOCBs that are slated to remain under public ownership and provide guidance on cases where an SOCB's commercial and non-commercial objectives are in conflict, and (v) rules on banking market concentration and other safeguards for market competition in collaboration with the CBU.

c. **Develop and improve monitoring and evaluation system for assessment of performance of SOCBs against the targets established under the approved restructuring plans.** The MOF should monitor the performance of SOCB to ensure they are successfully carrying out their mission. This would entail: (i) set expectations and jointly agree on appropriate indicators (KPIs) to measure the performance of the banks, including their restructuring process, and to set targets for those indicators; (ii) monitor the performance of SOCBs against those targets based on regular reports on the operations and management of SOCBs, including independent impact evaluation of the effectiveness of state policies/programs implemented through SOCBs. The project will also assist the MOF in developing a unified system for reporting government financial support programs, beneficiaries, uptake including by regions and targeted segments, gender etc. The definition of preferential loans needs to be revised.

d. **Deal with SOE and problem loans on SOCB's balance sheets ahead of privatization.** While UFRD-funded large SOE loans were removed from the SOCB balance sheets in end 2019, several SOCBs marked for privatization still have some significant credit portfolios of SOEs on their books (reaching 10-35 percent in some SOCBs). On top of this, loans provided at preferential rates (and which have low net interest rate margins) and future NPLs, may hamper privatization efforts of SOCBs, calling for the need to address them either through write-offs or transfer out of the books of SOCBs. MOF will need to adopt a comprehensive strategy to deal with these issues and the project will assist the MOF in this area.

e. **Communication and raising public awareness about SOCB restructuring and privatization program.** MOF needs to develop a communications strategy to support the SOCB reform agenda. This will entail the development of an overarching communications strategy around the transformation and privatization of SOCBs. This would also involve publication of annual report on the state-owned banking sector, comprising information such as recent developments in the sector, privatization plans and progress, financial and economic performance of state-owned banks, information on state lending programs, etc.

f. **Capacity building for the MoF Banking Reforms Department core-staff skills**. MoF Department staff working on restructuring and privatizations of SOCBs will need to work closely with financial, technical, and legal advisors hired with project funds. Government officials will need to be trained in several areas, including corporate governance standards, strategic planning and financial analysis, development of project concepts, information memoranda, how investors are identified, data rooms, bidding documents, evaluations, financial instruments, contract monitoring, etc. This will also support the MOF core staff to develop MOUs with other relevant state agencies to coordinate activities affecting SOCB transformation and privatization.

4. **Transactions-oriented technical assistance will be provided to MOF for privatization of select SOCBs**. Support will be provided to the MoF by financing technical assistance for select SOCBs in all stages, where there are identifiable public sector capacity needs, including consultant services to: (i) formulate recommendations for the privatization strategy and appropriate privatization mode, as well as sequencing of SOCB privatizations, (ii) develop procedural guidelines for various aspects of privatization (e.g., capacity building for bank asset valuations and their contracting, implementing privatization through transparent and competitive tenders, managing and overseeing privatization processes such as advertising, selection/evaluation criteria, privatization committee and decision making, negotiations), (iii) prepare and bring approved privatization projects to the market; (iv) prepare valuation reports, prospectuses, and bidding documents; (v) organize international, open and competitive tenders/biddings; (vi) evaluate bids (including based on screening criteria for potential strategic investors) and

selection of investors; and, (vii) close on privatization transactions, in coordination with the CBU conducting the fit and proper assessment of potential shareholders, including all necessary legal services. SOCB selection for privatization transactions will be based on the approved banking sector reform strategy for 2020-2025 that identifies the SOCBs up for privatization. To implement these functions effectively, the project will finance the hiring of lawyers, financial sector economists, investment bankers, privatization specialists, corporate finance specialists, valuations specialists, and other consultants by the MOF Banking Reforms Department, as needed. The procedural guideline for privatization of the state-banks should be developed and approved within the first 9 months after the project becomes effective, including for the purposes of clarifying the decision-making process and the roles of various state agencies in the privatization process of SOCBs.

In cases when, according to the approved privatization procedural guidelines and other relevant legal documents, some or all of the SOCB privatization procedures will be conducted by SAMA, this sub-component will also provide transactions-oriented consultancy support to SAMA, as needed.

5. **Sub-component 1.2: Consultancy services to support restructuring of SOCBs (US$3.2 million)**. SOCBs need to be restructured and implement governance and operational reforms ahead of privatization to create financially sustainable institutions with sound risk management and corporate governance practices in order to make them attractive to investors or as they refocus their role under public ownership. SOCB restructuring combined with transparent privatization process will be key for successful privatization. For the purposes of restructuring of SOCBs, this sub-component will support the following activities: (i) conducting diagnostic analyses for SOCBs, including asset quality reviews (AQRs), due diligence assessments, ICT audits, special diagnostics, market studies, and merger or acquisition feasibility studies, to be carried out by independent auditors, consulting firms and lawyers, as needed; (ii) review of business model and operations of SOCBs; and, (iii) preparation or update of existing SOCB transformation/restructuring plans based on the conducted diagnostic analyses and their implementation. The support will be provided to SOCBs with no support from other IFIs and consulting companies, or if the MoF identifies the need of undertaking additional analysis and consultancy support from the SOCB owners' or system perspective (in coordination with the CBU).

6. **Sub-component 1.3: Support to modernize SOCBs' core ICT infrastructure (US$2.4 million)**. This sub-component will finance investments in SOCBs to modernize core ICT infrastructure and to support the commercialization of SOCBs, specifically ICT systems and infrastructure, internal control and risk management systems, digitalization of bank process to reduce operational costs/risks and improve overall operational efficiency. The implementation of such investments could be undertaken with consultancy support where needed. This subcomponent will predominantly focus on the ICT modernization of the SOCBs that will stay in public ownership, but may also support SOCBs marked for privatization (including on cost-sharing basis with the bank owners and other IFIs (these investments will be recovered later through an increased sale price)). The project will also support the development of sound risk management systems in selected SOCBs, which will enhance the government efforts to reduce the risk of climate and geophysical hazards, and fiscal contingent liabilities. Specifically, enhancing participating SOCBs' ESMS system to align with the World Bank's ESF and ESS could strengthen the SOCBs' capacity to consider sustainability factors related to climate change, such as greenhouse gases accounting, energy efficiency investment, and careful disposal of electronic waste, etc.

7. **Sub-component 1.4: Support to the Banking and Finance Academy is proposed to help Uzbekistan meet demands for human resource development in the financial sector**. As a result of SOCBs traditionally acting as public-sector development agencies, the SOCBs staff and management lack necessary skills and knowledge in key competencies (e.g. credit underwriting, risk management and internal controls, corporate governance, etc). The challenge for SOCBs is to quickly enhance the knowledge and capabilities of the existing staff, as well as possibilities to attract new people with adequate qualifications. The Banking and Finance Academy (Academy)

was established in 1996 and is a state-owned highest educational institution for the purpose of training of management personnel and specialists in the banking, financial, and tax areas, as well as playing a role of scientific and informational analytical center. According to the Presidential Decree 4503 (October 31, 2019), the Academy was transferred under the ownership and management of the National Bank of Uzbekistan (NBU). The Presidential Decree 365 (June 8, 2020) approved the development concept and action plan of the Academy for 2020-2025 period. According to the adopted concept, the Academy will aim to create a cadre of highly skilled banking and financial sector specialists and managers that is needed to support the transformation efforts of the banking sector and promote sound, vibrant and competitive banking and financial industry.

8. **To date, the Academy has been facing difficulties in providing sufficient coverage and depth for short-term educational programs for the financial sector**. As a result, the list of main customers of the Academy has been limited to the largest state-owned banks. Moreover, Academy did not perform assessment of the satisfaction level of its customers. The 2020 study conducted by the CBU identified 16 directions (60 topics) that commercial banks are interested to be trained on. These topics reflect both the immediate needs for addressing the knowledge gap and building core competencies in the context of current sector transformation efforts (such as risk management, internal controls, compliance systems. accounting, HR, IT, etc.), as well as medium-term needs of banks (e.g. derivatives, soft skills, digital banking and cybersecurity, etc.). To address these gaps, the Academy will serve as a platform to streamline training assistance and institutionalize the capacity building program to meet short-term and long-term demands of the financial sector.

9. **The project will support the Academy in three major areas: (i) targeted, specialized and continuous short-term trainings for all levels of banking and financial sector specialists and people interested in financial sector careers, (ii) Training of Trainers program, and (iii) certification programs (US$2.0 million)**. Support to organizing and rolling out structured and continuous short-term trainings and knowledge sharing workshops will address the immediate, short-term and medium-term needs of banks and, especially, SOCBs in their restructuring efforts, and financial sector regulators (including CBU, MOF, IMDA). To this end, the following actions will be supported by the project: (i) implement a comprehensive training needs (demand) and supply analysis, (ii) develop a formalized training master plan including a prioritization and planning of how all training needs will be conducted, (iii) design, build and roll-out the training program as per the master plan and fit for various levels of financial sector staff, (iv) develop evaluation system to assess the level of satisfaction of both the participants of the program and their (current or potential) employers, and (v) develop necessary internal process, procedures and regulations for the Banking and Finance Academy for effective and efficient implementation of the short-term trainings, including the selection criteria and process of hiring trainers with necessary knowledge, skills and experience. Where needed, the Academy will also cooperate and coordinate with the IFIs which also provide trainings to the banking and financial sector of Uzbekistan.

10. **The project will also support the development and implementation of the Training of Trainers program and certification programs**. This will be aimed at creating a local pool of trainers that will be able to deliver required training programs in future, ensuring the sustainability of the Academy's efforts once the project ends. Introduction of certification programs will help create a pool of specialists in the banking system having necessary international qualifications. The project will help identify the priority 2-3 main certification programs that could be supported by the Academy, implement necessary activities to enable holding international certification examinations in Uzbekistan and, where needed, design and implement specific training programs to assist the candidates in preparing for these examinations.

11. **The project will also finance the partial scholarship grant program for people who want to pursue new career in the financial sector and compete for financial sector jobs.** The sub-component will partially finance the tuition fees of Banking and Finance Academy students who want to enter the financial system for the short-term

trainings mentioned in sub-paragraph (a) and (c) above as needed. The partial scholarship grants shall be provided according to the partial scholarship grant program guidelines developed and approved by the Banking and Finance Academy with the support provided under sub-paragraph (a) and to the extent acceptable to the Bank, and as incorporated to the Project Operations Manual. The partial scholarship grant program guidelines should outline, among other things, the terms and conditions of the partial scholarship grants, eligibility criteria and selection/evaluation procedures for partial scholarship grants beneficiaries, partial scholarship grant payment mechanisms, as well as monitoring and reporting requirements. The beneficiary eligibility criteria shall pay particular attention to gender and regional aspects, with the objective to maximize the benefits for most disadvantaged groups. The total budget for individual partial scholarship grants will be limited to US$200,000 over the first two years of the project since its effectiveness date. After the first two years of the project since its effectiveness date, the effectiveness of training partial scholarship grants will be jointly evaluated by the Banking and Finance Academy, MOF, and the World Bank. If the implementation is deemed successful, the budget for partial scholarship grants can be extended over the remaining period of the project and be limited to additional US$500,000 out of the total funding allocated for this sub-component.

This sub-component activities will be closely coordinated with the CBU’s Department for Improving Financial Literacy and Retraining Banking Specialists.

12. **Component 2: Financial preparedness to disasters and strengthening insurance sector stability (US$2.7 million).** This component aims to support the development of national disaster risk financing (DRF) strategy, its implementation, and capacity building for the IMDA in developing and improving disaster risk insurance and general insurance regulatory and supervisory framework. This component consists of two sub-components.

13. **Sub-component 2.1: Develop a national disaster risk financing strategy (US$1.2 million).** Recent events associated with strong storms in the south of Uzbekistan and collapse of Sardoba reservoir showed that the government of Uzbekistan relies heavily on ex-post domestic public finance to cover the cost of disasters. Such an approach has a high opportunity cost and can cause delays in provision of post-disaster assistance. It also affects budget discipline and credibility. DRF is an approach to strengthening financial preparedness to disasters and crises through a better financial planning. It helps protecting the economy and state budget, alleviating disaster impacts on households especially the most vulnerable. It includes building a risk layering strategy that allows governments to provide enough financing when and where it is most needed, as well as developing risk financing instruments for households, businesses or farmers. This sub-component will support the MOF to develop and implement a national disaster risk financing strategy, in particular:

a) **Development of a national DRF strategy:** This sub-component will support the preparation of a national DRF strategy, including identifying and quantifying government contingent liabilities due to climate induced (and thus impacted by changing climate) and other disasters. The strategy will define the government’s risk appetite on what risks to retain versus transfer, and design a corresponding risk layering approach to address increasing disaster costs, both from frequent and rare disasters. The sub-component will finance analytics, consulting services, preparation of the strategy and action plan, and capacity-building/awareness increasing activities for all relevant stakeholders. This strategy will determine priorities in management of the government contingent liabilities and set out actions to address these priorities. These actions may focus on improving the existing risk financing instruments and/or introducing new and more diversified ones based on a risk layering approach (i.e., combining different sources of financing). The MoF will lead the development in coordination with multiple government stakeholders. Specifically, the work will be implemented in coordination with country stakeholders responsible for data (e.g. hydromet, statistics) and disaster risk management (in addition to other sectoral stakeholders, such as those involved in public asset reconstruction, providing funds to the affected people, agriculture, etc.) both in the government and development partners. This work will be supported by a funding gap assessment and catastrophe risk modeling developed through an upstream World Bank TA. This includes Disaster Risk Management technical assistance funded by the European Union, implemented in close collaboration with World Bank Disaster Risk Management team.

b) **Support implementation of a national DRF strategy:** Based on the adopted DRF strategy, this sub-component will support establishment and operationalization of risk financing instrument, such as a reserve fund or centralized insurance pool. In particular, the project will support the following activities:

(i) Prepare a feasibility study for a DRF instrument as provided in the DRF strategy implementation plan;

(ii) Develop technical design of the structure of the instrument, including its objectives (of what the instrument will finance), governance, institutional structure, product (if any), disbursement mechanism, financing strategy;

(iii) Draft a presidential resolution/law on establishment, objectives, scope, programs, implementation modalities and regulation and supervision of the reserve fund/insurance pool, based on international experience and comparable private sector structures;

(iv) Develop standard operating procedures and other operational documents (such as guidelines, manuals, regulations, etc.);

(v) Implement reserve fund's or centralized insurance pool's funding structure, which could involve initial capital injection by the government, subsequent budget transfers, as well as contributions from donors, private sector and insurance premiums;

(vi) Adopt and implement a risk financing plan that is reviewed and updated annually, potentially leveraging on (re)insurance sector;

(vii) Implement reserve fund/insurance pool's governance, staffing, audit and reporting, including anti-corruption measures, risk data and analytics, damage reporting, funding request submissions, damage assessment and claims handling system, etc.;

(viii) Finance infrastructure and operational enhancements, under potential PPP arrangement,

(ix) Develop communication strategy, implement awareness-raising and capacity building for the staff, government agencies and other stakeholders.

14. The risk data and information collected and produced under this Component will also be used for the benefit of Component 1. For example, the risk data can be used to estimate the impact of climate change on NPLs, including disaster-prone areas (e.g. flood plains) which can impact banks' credit portfolios. Risk data can help understand where assets are located, what is their value and overlay this data with hazard information. This data and information can also help the government to strategize on measures to strengthen financial resilience of the banking sector (e.g. payment holidays to the affected people, disbursement of compensations or social protection support).

15. **Sub-component 2.2: Capacity building for IMDA (US$1.5 million).** Strengthening the regulatory and supervisory framework in the insurance sector is a critical part of the financial sector reform program and is critical to the success of DRF strategy implementation. Strengthening the capacity of the IMDA to perform its supervisory

duties remains crucial for proper development of the insurance market. A credible and independent regulator is the necessary anchor for an effective and resilient financial system. This is also needed for ensuring financial stability of the banking system, as the latter has a sizeable exposure to insurance companies, including through credit risk insurance (around 12 percent of banking sector credit portfolio is secured with credit risk insurance as of end 2021).[56] This sub-component aims at strengthening the IMDA to regulate and supervise the insurance sector in line with IAIS core principles (as updated in 2019). In particular, this component will finance consultancy services to:

a. Review and improve organizational structure of the IMDA;

b. Introduce modern regulatory reporting system on catastrophic risks to increase transparency;

c. Increase IMDA capacity to set up rules, regulations and guidelines (including on capital and solvency regime) to improve insurance products and market practices;

d. Develop risk-based supervisory framework to assess and monitor risks, including climate related risks in Uzbekistan;

e. Improve the IMDA's ICT infrastructure for data collection, validation, storage and analyses, improvement of data regulatory reporting templates by the insurance market participants;

f. Develop risk transfer mechanism to prevent risk accumulation and regulate disaster insurance, including risk-based pricing and policyholders' protection scheme;

g. Provide capacity building and training for IMDA staff (including through on-the-job training, exchange visits) to help improve understanding of Insurance Core Principles, and international good practices in regulation and supervision of insurance sector, and disaster risk insurance, in particular.

The ADB is also providing support to the IMDA in the area of upgrading the regulatory framework, divesting state ownership in insurance companies, broadening investment mandates and cross-regulatory cooperation. A strong coordination and collaboration between the WB and ADB will be ensured to avoid any potential overlaps. This work is supported through an upstream World Bank Disaster Risk Management TA, which funded a review of the insurance strategy regarding catastrophe risks to contribute to the draft Insurance Sector Development strategy.

16. **Component 3: Development bank, export and trade financing instruments (US$1.7 million)**. This component aims to: (i) support the establishment of a development bank in Uzbekistan; and (ii) support improvement of export and trade financing instruments that the development bank can later house. This component consists of two sub-components.

17. **Sub-component 3.1: Technical assistance to MIFT to support the establishment of a development bank in Uzbekistan (US$1.0 million).** This sub-component will support the MIFT in developing and implementing the concept note for creating a new development bank in Uzbekistan. In particular, the project will finance consultancy services to:

a) Develop the concept for a new development bank (DB) in Uzbekistan, which should, among other things, cover such aspects as rationale and value proposition for a new DB, envisaged mandates and key market failures to be addressed, DB's additionality relative to other SOCBs and public agencies carrying out

[56] By end-2021, insurance companies had deposited of about UZS 2.1 trln with commercial banks (1.3 percent of total bank deposits), mostly in local currency.

developmental functions or approach to consolidating/integrating such functions, DB's structuring, governance, instruments, and operational regulation and oversight, and accountability mechanisms;

b) Draft a law or separate legal act for the establishment and operation of the new development bank, in line with the adopted concept, and other related necessary regulations;

c) Develop the technical design of the DB, its strategy, business plan, financial model and instruments, corporate governance and risk management system, operational policies and procedures, including credit and investment policies, staffing strategy, pricing of DB's financial instruments, monitoring and evaluation frameworks, return, impact, and risk metrics.

18. **Sub-component 3.2: Technical and institutional building support to the EPA and ESuF in improving and enhancing its export, import and trade finance products (US$0.7 million):** This sub-component will finance: (i) consultancy services to conduct a comprehensive review and assessment of the ESuF's operations and efficiency of its export and trade financing instruments, with the possibility to broaden them; (ii) capacity building for the staff of EPA and ESuF on export/import and trade finance instruments, including through fact-finding and study visits to solid foreign partners for on-site learning; and (iii) financing for carrying out financial education and awareness workshops for exporting MSMEs (especially in remote regions) to increase awareness and understanding of the export and trade financing instruments offered by the ESF through commercial banks.

19. **The Export Support Fund (ESuF) was established in October 2020 under the Export Promotion Agency (EPA)**. The ESuF currently has two employees and directly reports to Director of the EPA. The ESuF does not have a status of a legal entity. The Fund's equity in the amount of US$100 million was injected by the UFRD, which in addition provided an additional US$100 million loan to the Fund in 2021 at preferential rate of 1 percent. The allocated US$200 million funds are intended for provision of one-time, short-term (less than a year), foreign currency pre-export financing loans (up to US$1 million per each entity) through commercial banks to exporting companies. According to the Presidential Decree 6306 (dated September 7, 2021), the ESuF was allowed to provide larger amount of pre-export financing (up to 5 million US dollars for a period of up to one year) through commercial banks to exporting companies whose annual export volume exceeds 20 million US dollars. As of end 2021, commercial banks through the ESuF have provided a total of around US$142 million USD pre-export financing loans to 271 exporting companies, with a total export turnover of 471 mln USD. The loans are provided in US dollar, at 4 percent interest rates (banks earn 2 percent margin). Exporting companies, which receive ESuF-funded pre-export financing loans, are not entitled for receiving interest rate compensation by the State Fund for Entrepreneurship Support, as the interest rate of these loans are already at subsidized levels.

20. **ESuF provides financing to participating financial institutions based on the internal regulation approved by the Government Commission on Export and Investment Development**. PFIs currently include only commercial banks, and there are no criteria established for such PFIs. The ESuF currently cooperates with 20 commercial banks. There are no specific criteria for final beneficiaries – exporting companies either, and the credit risk of the borrower rests with the PFIs. There are no KPIs set for the ESuF and the ESuF does not collect information on the size of the final beneficiaries (i.e. micro, small, medium and large).

21. **Component 4: Project Management (US$0.8 million).** This component will finance the functioning of the project implementation unit (PIU) and overall project implementation and management costs, in particular: (i) incremental implementation costs for staff and operating expenses (including office equipment, travel, communication, printing, translation, and transportation) in the PIU at the MoF that will, inter alia, manage the provision of financial resources, perform fiduciary functions, ensure compliance with environmental and social safeguards, monitor and evaluate the project, (ii) just-in-time technical assistance (contingency), which will involve

financing of activities that contribute to the achievement of the PDO but were not identified during the preparation in order to respond to emerging needs and priorities of the government during the SOCB restructuring and privatization.

ANNEX 3: Selected macroeconomic and banking system indicators

COUNTRY: Uzbekistan
Uzbekistan Financial Sector Reform Project

Table 1. Uzbekistan: Macro poverty outlook selected indicators

(annual percentage change, unless indicated otherwise)

	2017	2018	2019	2020	2021e	2022f	2023f
Output							
Real GDP growth, at constant market prices	4.5	5.4	5.7	1.9	7.4	3.6	5.3
Private Consumption		3.8	5.3	0.1	7.1	0.6	2.9
Government Consumption		3.7	5.7	1.4	6.1	4.7	4.5
Gross Fixed Capital Investment		18.1	38.1	-4.4	5.2	-0.4	7.1
Exports, Goods and services		10.7	16.2	-20.0	4.8	13.1	13.8
Imports, Goods and services		26.8	13.3	-15.0	5.8	1.0	8.9
Prices							
Inflation (Consumer Price Index)	12.5	17.5	14.5	12.9	10.8	11.9	10.6
Nominal Exchange rate (local currency per USD)	8,120	8,339	9,507	10,476	10,837	…	…
Public Finances and External accounts							
Fiscal Balance (% of GDP)	-1.9	-2.1	-3.9	-4.5	-6.2	-4.0	-2.9
General Government Debt (% of GDP)	20.2	20.3	29.7	39.0	38.1	42.0	42.1
Current Account Balance (% of GDP)	2.5	-7.1	-5.8	-5.0	-6.6	-10.2	-7.1

Source: GDP components, Inflation, current account balance, fiscal balance, and public debt are taken from the recent "Uzbekistan Macro-Poverty Outlook Spring 2022"; real exchange rate, and foreign direct investment are from "IMF, Republic of Uzbekistan 2021 Article IV Consultation - staff report, April 2021".

Table 2. Uzbekistan: Selected Banking Sector Indicators, 2018-2021

	2018	2019	2020	2021
Credit portfolio				
Credit portfolio growth	51%	58%	31%	18%
of which: state-owned banks	51%	62%	31%	15%
of which: private banks	55%	34%	30%	35%
Share of preferential loans to total loans	71%	58%	46%	39%
of which: state-owned banks	78%	64%	51%	44%
of which: private banks	18%	19%	11%	5%
Share of credit portfolio to total assets	78%	78%	76%	73%
Capital adequacy				
Total Regulatory capital to risk-weighted assets	16%	24%	18%	17%
of which: state-owned banks	15%	25%	18%	18%
of which: private banks	17%	18%	19%	17%
CET 1 capital to risk-weighted assets	14%	20%	15%	15%
Leverage ratio (Capital to assets)	9%	14%	11%	12%
Asset quality				
Non-performing loans to total gross loans	1.3%	1.5%	2.1%	5.2%
of which: state-owned banks	1.4%	1.5%	2.1%	5.4%
of which: private banks	0.7%	1.5%	2.0%	4.1%
Non-performing loans net of provisions to regulatory capital	5%	3%	4%	13%
Profitability				
Net interest income to average interest-bearing assets (NIM)	3.9%	4.3%	5.0%	5.0%
of which: state-owned banks	3.3%	3.7%	4.5%	4.3%
of which: private banks	7.3%	8.3%	8.5%	8.9%
Operating costs to net income (CIR)	49%	41%	36%	38%
of which: state-owned banks	49%	40%	34%	36%
of which: private banks	48%	45%	44%	45%
Return on assets	2.0%	2.2%	2.2%	1.3%
of which: state-owned banks	1.6%	1.8%	1.8%	0.7%
of which: private banks	4.2%	4.7%	4.3%	4.3%
Return on equity	16.2%	16.7%	10.3%	6.1%
of which: state-owned banks	13.1%	13.7%	8.4%	3.0%
of which: private banks	29.5%	30.8%	20.7%	20.2%
Liquidity				
Liquid assets to total assets	14%	14%	15%	19%
of which: state-owned banks	10%	11%	13%	15%
of which: private banks	33%	27%	30%	33%
Liquid assets to short-term liabilities	41%	40%	67%	47%
of which: state-owned banks	35%	37%	54%	43%
of which: private banks	57%	50%	142%	57%
FX exposure				
Net FX open position to Total Regulatory capital	8%	7%	4%	6%
Ratio of FX loans to total loans	56%	48%	50%	50%
of which: state-owned banks	59%	49%	51%	52%

of which: private banks	33%	38%	39%	37%
Ratio of FX liabilities to total liabilities	63%	58%	60%	57%
of which: state-owned banks	66%	60%	61%	59%
of which: private banks	48%	49%	51%	45%

Source: CBU

ANNEX 4: Technical Assistance Support to the Central Bank of Uzbekistan 2019-2021

COUNTRY: Uzbekistan
Uzbekistan Financial Sector Reform Project

The following achievements have been reached through various TA support activities provided to the CBU:

1. FinSAC TA support (2018-2021)

a) Support to the development of new Law on Banks and Banking in line with international standards which was adopted in November 2019

b) Comprehensive self-assessment against Basel Core Principles, which was concluded in end 2019, with a 3-year action plan to address identified gaps in regulatory and supervisory framework

c) A number of regulations have been developed and amended to bring them in line with international standards, including bank licensing (2020), corporate governance (2020), risk management (2020), liquidity risk (2020), large exposures framework (2020), internal audit (2021), asset classification (phase 1, 2021), prudential reporting (2019-2021), and external audit (2022).

d) Support to the development of internal manuals, including bank licensing manual (2021), comprehensive risk-based supervision manual (SREP, 2021, ongoing), methodology for assessment of domestic systemically important banks (2021), supervisory enforcement and sanctions manual (2021) and internal note on establishing effective relationship with external auditors (2021).

e) Support to the development of SupTech in the CBU, including report on the assessment of the reporting infrastructure of the banking system of Uzbekistan (2020), development of SupTech strategy (2021, ongoing)

f) Development of supervisory products, including institutional overview for all banks, comprehensive system of supervisory indicators, off-site analyses reports, risk profiles, stress-testing, and thematic inspections (2020-2021, ongoing).

g) Capacity building trainings on various supervision-related topics

2. FIRST 2.0 TA support (2021-2022)

a) Developed policy note on establishing a sound bank resolution framework and revisiting the current deposit insurance framework (2021). The respective laws will be drafted in 2022.

b) Support to strengthening the AML/CFT supervision, including a comprehensive report on assessing the regulatory and supervisory practices, with a roadmap to address exiting gaps (2021)