



# FAST Report

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Project Number: 48348-001  
June 2015

## Senior Unsecured Loan Bai Tushum Bank Broadening Access to Finance (Kyrgyz Republic)

This is a redacted version of the document that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

## CURRENCY EQUIVALENTS

(as of 13 April 2015)

Currency unit	–	som (Som)
Som1.00	=	\$0.0156
\$1.00	=	Som63.90

## ABBREVIATIONS

ADB	–	Asian Development Bank
BTB	–	Bai Tushum Bank
CAGR	–	compounded annual growth rate
CAR	–	capital adequacy ratio
CEO	–	chief executive officer
FAST	–	Faster Approach to Small Nonsovereign Transactions
GDP	–	gross domestic product
IFC	–	International Finance Corporation
MSMEs	–	micro, small, and medium-sized enterprises
NBKR	–	National Bank of the Kyrgyz Republic
NSDS	–	National Sustainable Development Strategy
TA	–	technical assistance

## NOTE

In this report, "\$" refers to US dollars.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 48348-001</b>	
<b>Project Name</b>	Senior Unsecured Loan to Bai Tushum Bank for Broadening Access to Finance	<b>Department /Division</b>	PSOD/PSFI
<b>Country</b>	Kyrgyz Republic		
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ Finance	Small and medium enterprise finance and leasing		10.00
		<b>Total</b>	<b>10.00</b>
<b>3. Strategic Agenda</b>		<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>		<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Client relations, network, and partnership development to partnership driver of change	Effective gender mainstreaming (EGM)	✓
Knowledge solutions (KNS)	Institutional development		
Partnerships (PAR)	Knowledge sharing activities		
Private sector development (PSD)	Commercial cofinancing Implementation International finance institutions (IFI) Private Sector Promotion of private sector investment		
<b>5. Poverty Targeting</b>		<b>Location Impact</b>	
Project directly targets poverty	No	Nation-wide	High
<b>6. Nonsovereign Operation Risk Rating</b>			
<b>Obligor Name</b>	<b>Obligor Risk Rating Local Currency</b>	<b>Obligor Risk Rating Foreign Currency</b>	<b>Facility Risk Rating</b>
Bai Tushum Bank	NSO12	NSO12	NSO13
<b>7. Safeguard Categorization</b> Environment: FI    Involuntary Resettlement: FI    Indigenous Peoples: FI			
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>10.00</b>	
Nonsovereign LIBOR Based Loan: Ordinary capital resources		10.00	
<b>B-Loans</b>		<b>0.00</b>	
None		0.00	
<b>Official Cofinancing<sup>a</sup></b>		<b>0.00</b>	
None		0.00	
<b>Others<sup>b</sup></b>		<b>0.00</b>	
<b>Total</b>		<b>10.00</b>	
<b>9. Effective Development Cooperation</b>			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

<sup>a</sup> Concessional financing from external sources.

<sup>b</sup> Derived by deducting ADB financing, B Loans and Official Cofinancing from Project Total Cost.

## I. INTRODUCTION

1. This is an eligible transaction under the Faster Approach to Small Nonsovereign Transactions (FAST) framework.<sup>1</sup> The transaction involves (i) a senior unsecured loan of up to \$10,000,000 (a portion of which may be provided in an equivalent amount of som), and (ii) capacity development technical assistance (TA) from an existing TA to Bai Tushum Bank (BTB) for Broadening Access to Finance in the Kyrgyz Republic.<sup>2,3</sup>

## II. THE FINANCIAL INTERMEDIARY

### A. Investment Identification and Description

2. Growth in the Kyrgyz Republic slowed to 3.6% in 2014 as the economies of the Russian Federation and Kazakhstan weakened, while the local currency depreciated by 19.1%, and inflation increased to 7.5%. The economy of the Russian Federation is expected to continue to contract over the short term, and growth will likely slow further to 1.7% in 2015 before a slight rebound to 2.0% in 2016 as the external environment improves.<sup>4</sup> High rates of poverty (37.0%) and unemployment (8.3%) in the Kyrgyz Republic in 2014 add to the challenges facing rural and urban areas of the country.<sup>5</sup> Micro, small, and medium-sized enterprises (MSMEs) can play a catalytic role in the development process of frontier economies and act to stimulate economic growth. They serve to increase individual incomes and create employment, and are thus key contributors to poverty reduction. The MSME sector's contribution to employment increased from 15.5% in 2011 to 18.9% in 2013, while the contribution to gross domestic product (GDP) was 39.5% in 2011, declining slightly to 38.8% in 2013.<sup>6</sup>

3. Growth in the MSME sector has been modest, and hampered by a number of factors. A 2013 International Finance Corporation (IFC) study on the SME sector cites political instability, tax reporting, corruption, and limited access to loans as the most burdensome factors for doing business.<sup>7</sup> The political situation in the Kyrgyz Republic has stabilized after the political strife in 2010, and the ensuing economic growth has increased total bank assets, by 23.9% during 2013–2014, reaching Som137.6 billion. However, the Kyrgyz Republic's level of financial services outreach is still one of the lowest in Central Asia and the Caucasus, with an asset-to-GDP ratio of 34.5%, and a credit-to-GDP ratio of 16.3% at the end of 2014.<sup>8</sup> The low level of banking intermediation results from (i) the significant informal sector; (ii) a cash-based economy; and (iii) a continued focus by banks on large, top-tier companies that are perceived to carry less risk.

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<sup>1</sup> Asian Development Bank (ADB). 2015. *Faster Approach to Small Transactions*. Manila.

<sup>2</sup> ADB will complement the proposed investment with TA from the ongoing ADB. 2013. *Technical Assistance for Promoting Financial Inclusion and Stability in ADB's Transition Member Countries*. Manila.

<sup>3</sup> The design and monitoring framework is in Appendix 1.

<sup>4</sup> ADB. 2015. *Asian Development Outlook 2015*. Manila.

<sup>5</sup> National Statistics Committee of the Kyrgyz Republic. 2014. *Report on the Welfare of the Population in the Kyrgyz Republic 2009–2013*. Bishkek.

<https://www.cia.gov/library/publications/the-world-factbook/docs/whatsnew.html>.

<sup>6</sup> State Statistics Committee of the Kyrgyz Republic.

<sup>7</sup> IFC. 2013. *Investment Climate in the Kyrgyz Republic as seen by Businesses*. Bishkek. While the study is on SMEs, these are defined to include enterprises with a turnover up to Som4 million (\$66,000), which includes microenterprises.

<sup>8</sup> ADB. 2014. *Key Indicators for Asia and the Pacific 2014*. Manila; Government of the Kyrgyz Republic. 2014 *National Financial Market Regulation and Supervision Service of the Kyrgyz Republic*. Bishkek; and Sector Overview (accessible from the list of linked documents in Appendix 2).

4. The provision of medium and long-term financing is essential to enable MSMEs to expand and increase their productivity and competitiveness. The Asian Development Bank (ADB) provided a loan to Kyrgyz Investment and Credit Bank in 2011 for onlending to MSMEs.<sup>9</sup> Continued access to finance will also be critical during the current economic downturn. Given the need to support growth in the banking and MSME sectors, ADB has continued to search for sound commercial banks with an inclusive focus of supporting underserved customer segments.

5. BTB, established in 2000 as a local microfinance institution and the first microfinance institution in the Kyrgyz Republic to obtain a banking license (2012), was identified as a potential candidate for ADB funding.<sup>10</sup> In terms of market share as of December 2014, BTB ranks sixth for total loans and eighth for total assets.<sup>11</sup> Its strategic mission is to promote equitable inclusive growth across the country by funding and supporting socially important projects and initiatives. With technical advisory services from IFC, Triple Jump, and the European Bank for Reconstruction and Development, BTB has been able to strengthen its financial position and build a good MSME platform. In May 2014, BTB was recognized by Microfinanza Rating for their commitment and practice to treat the people they serve fairly; as a result, BTB was “smart-certified” as having followed client protection principles.<sup>12</sup>

## **B. Business Overview and Strategy**

6. BTB currently serves 32,000 clients and provides a diverse range of financial services to entrepreneurs, MSME borrowers, and small corporations. Following its conversion to a bank, BTB has continued to position itself to capture broader customer segments and to respond to growing demand.

7. BTB categorizes MSME customers by annual turnover (footnote 12) and tailors its relationship management approach as well as product offering to each MSME sub-segment. An integral part of its branch expansion plan through ATMs and branches is the “one-stop shop,” where continuous (24 hours) contact is available. Through these regional outlets, BTB can provide banking services, maximize cross-sale opportunities, and offer comprehensive financing solutions to the MSME segment.

8. To lower its cost of funding, BTB plans to increase its savings and demand deposit bases and continue to diversify its funding sources from development financial institutions and commercial banks. BTB plans to fund 50.0% of its MSME portfolio by raising deposits from customers and the remaining 50.0% through borrowings. BTB projects that it will need to raise \$152.0 million between 2015 and 2018 in order to meet its growth targets.

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<sup>9</sup> ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Unsecured Loan to Kyrgyz Investment and Credit Bank for Small and Medium-Sized Enterprise Finance in the Kyrgyz Republic*. Manila.

<sup>10</sup> BTB was established in 2000 by ACDI/VOCA with the support of CARITAS Switzerland, a relief agency providing microcredit services to private entrepreneurs, traders, farmers, and micro and small agricultural enterprises.

<sup>11</sup> European Bank for Reconstruction and Development peer review of Kyrgyz Republic banks, 2014.

<sup>12</sup> Client protection certification is an independent, third party evaluation to publicly recognize financial institutions that meet adequate standards of care to implement all of the client protection principles throughout their operations, product offerings, and treatment of clients.

[http://www.microfinanzarating.com/index.php?option=com\\_content&view=article&id=236&Itemid=193&lang=en](http://www.microfinanzarating.com/index.php?option=com_content&view=article&id=236&Itemid=193&lang=en)

## C. Ownership, Management, and Governance

9. **Ownership.** BTB's main shareholders are the Microcredit Agency Financial Fund Bai Tushum,<sup>13</sup> which holds 46.3%; Pettelaar Effectenbewaardbedrijf NV, acting in the interests of ASN-NOVIB Fund, represented by Triple Jump, Bamboo Financial Inclusion Fund, and Credit Suisse Microfinance Fund, each holding 15.2%; and individuals holding 8.1%.<sup>14</sup> ADB's review of the above does not give ADB cause to believe that any entity has been established or is being used for cross-border tax evasion, money laundering, or terrorism financing in the jurisdictions involved in the investment.<sup>15</sup>

10. **Management and governance structure.** BTB's board of directors comprises seven members who bring extensive international banking and other professional experience to BTB. The board includes three independent non-executive directors and four non-executive directors. The roles of the board chair and the chief executive (CEO) are separated. The board approves BTB's strategic plan and key policies, and monitors their implementation through the board committees and key management personnel, who are appointed by the board. There are three board committees: (i) audit committee, (ii) finance and risk committee, and (iii) ethics and human resource committee. Additionally, there are two sub-board committees: (i) social projects subcommittee, and (ii) credit subcommittee. Board committee meetings are held monthly or as and when required.

11. BTB benefits from a strong management team. G. Shamshieva, the CEO, has been with the bank since it began as a microfinance institution and has been the CEO since 2001. The first deputy CEO started with the institution in 2009 as a finance manager and was then promoted to the current position in 2010. Members of BTB's senior executive management team have strong academic and professional backgrounds, and most have extensive banking experience. Four management committees meet monthly or biweekly as needed: (i) assets and liabilities committee, (ii) credit committee, (iii) risk management committee, and a (iv) tender commission committee.

## D. Financial Performance

12. BTB has experienced strong growth due to rising demand for financial services. Total assets increased from Som4.80 billion in 2012 to Som7.9 billion in 2014, which represented a compounded annual growth rate (CAGR) of 27.5%. Gross customer loans grew from Som3.0 billion in 2012 to Som6.4 billion in 2014 (CAGR: 46.1%). Total customer deposits also grew at a robust CAGR of 182.7% over the same period, from Som89.7 billion to Som717.2 billion. The financial strength of the Kyrgyz Republic banks is helped by strict prudential regulations that

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<sup>13</sup> Bai Tushum Financial Fund, which was founded in September 2000, was established through a combination of programs run by two nongovernment organizations: ACDI/VOCA and CARITAS Switzerland. ACDI/VOCA was formed as a result of the 1997 merger of Agricultural Cooperative Development International and Volunteers in Overseas Cooperative Assistance. CARITAS Switzerland is an association which operates as an independent, multi-functional relief agency with 165 organizations worldwide.

<sup>14</sup> Triple Jump was established by the NOTS Foundation, a Dutch development organization; Oxfam Novib, a Dutch organization for international cooperation and development; ASN Bank, a sustainability driven Dutch bank and the management team. Triple Jump is comprised of Triple Jump Fund Management (TJFM) and Triple Jump Advisory Services. Triple Jump Fund Management manages five microfinance investment funds, with total assets of €475 million as of the end of 2014. Bamboo Finance was launched in 2007 and manages \$250 million represented by two global funds in a combined portfolio operating across 30 emerging economies. A total of 26 individual shareholders own 8.1%, with no individual owning more than 1.2% of the shareholdings.

<sup>15</sup> Ownership, Management, and Governance (accessible from the list of linked documents in Appendix 2).

include a minimum capital adequacy ratio of 12%, and strict requirements on liquidity, provisioning, and open foreign currency positions.<sup>16</sup>

13. **Capital adequacy.** BTB is well capitalized with a tier 1 capital ratio in December 2014 of 12.1%, down from 15.3% in 2013, and total capital adequacy ratio (CAR) of 16.8% (Basel I standards), down from 19.8%, in 2013.<sup>17</sup> The decrease in CAR from the previous year is due to BTB incurring additional costs to introduce new banking operations and procedures, and improve the regional network in line with the requirements of the NBKR. However, BTB remains well above the regulatory minimums of 6% for tier 1 capital ratio and 12% for total CAR, which gives BTB good absorptive capacity.<sup>18</sup>

14. **Earnings and profitability.** Net income grew by 224.8% in 2014, to Som201.4 million; up from Som62.0 million in 2013 (when income growth was 70.8%). As of December 2014, net interest income was Som839.5 million, up from Som608.8 million in 2013, and non-interest income was Som3.0 million, up from –Som37,587 million in 2013. The increase in interest income was due to growth of the loan portfolio, while the increase in non-interest income was due to the bank's focus on fee income from money transfers, remittances, and guarantee issuances. The net interest margin increased by 1.1 percentage points, from 12.1% in 2013 to 13.2% at the end of 2014 due to higher yields from MSME and retail loans. The cost-to-income ratio improved from 82.6% in 2013 to 74.9% in December 2014 because of a focus on business optimization programs within the bank, which increased cost efficiency and income growth. The bank has invested heavily in branches, information technology, and employees as part of its transition plan. The cost-to-income ratio is expected to decline to 69% by 2018 because of operational efficiency gains. As of December 2014, return on assets increased to 2.8% from 1.1% in 2013, and return on equity to 20.7% from 7.7% in 2013. This was above 2014 banking sector averages of 2.6% for return on assets and 18.7% for return on equity.

15. **Loan portfolio and asset quality.** BTB's gross loan portfolio continued its strong growth pattern, increasing by 50.6% to Som6.4 billion in 2014, up from 39.3% and Som4.2 billion in 2013.<sup>19</sup> BTB maintains a diversified portfolio in terms of concentration by sector. The largest industry concentrations in 2014 were loans for agriculture, which comprised 33.0% of the loan portfolio, followed by mortgage (23.8%), trade (23.0%), services (5.6%), transport (3.4%), and others (11.2%). In 2014, BTB's average loan size was Som270,000 and the average loan tenor was about 23 months; for MSME loans the tenor was 2 years and loan size was Som1.3 million.<sup>20</sup>

16. BTB's asset quality continued to improve, with a nonperforming loan ratio of 2.3% in 2014 (2013: 2.6%), which is lower than the sector average of 4.5% as of the end of 2014. BTB's gross nonperforming loan coverage ratio was high at 100.5% as of the end of 2014 (2013: 133.9%).<sup>21</sup> In addition to specific provisions for nonperforming loans, BTB maintains a general provisioning of 2%–5% on all its performing loans, as required by the NBKR, and has a

<sup>16</sup> NBKR levels: (i) liquidity: 30%; (ii) provisioning: satisfactory loans: 2%; watch loans (past due up to 30 days): 5%; substandard loans (past due 30–60 days): 25%; doubtful loans (past due 60–90 days): 50%; loss loans (past due over 90 days): 100%; and (iii) aggregate open foreign currency position: 20%.

<sup>17</sup> Industry average: Tier 1 capital ratio 16.4% and total CAR 21.8% as of the end of 2014.

<sup>18</sup> NBKR. 2014. *Annual Report 2013*. BTB Annual Report 2013. Bishkek.

<sup>19</sup> Sector average is 42.5% at the end of 2014.

<sup>20</sup> Based on information provided by BTB management in February 2015.

<sup>21</sup> Under NBKR standards, which are more stringent than International Financial Reporting Standards, the ratio was 148.0%.



collateral value amounting to 120% on 99.7% of its loan portfolio.<sup>22</sup> BTB is targeting a coverage ratio of a minimum of 100%.<sup>23</sup> In 2014, exposure to the top 20 group obligors was moderate (29% of total capital) and the bank did not engage in any related party lending (NBKR limit is 15%), reflecting BTB's strict policy on transparency and the avoidance of conflict of interest.<sup>24</sup>

17. **Funding and liquidity.** BTB's main source of funding was borrowings, which accounted for 86.0% of total liabilities as of December 2014 (down from 90.0% in 2013), and contributed to higher funding costs. Deposits accounted for 10.4% of total liabilities, having grown from 6.2% in 2013, while "others" made up 3.6% of total liabilities at the end of December 2014.<sup>25</sup> Customer deposits grew 103.9% as of December 2014, down from 291.0% in 2013, but faster than the sector average deposit growth rate of 22% in 2014. Deposit taking began only recently, and BTB is thus starting from a very small base, resulting in the high percentage growth rate. BTB intends to continue to increase the deposit base significantly and reduce borrowing, with the goal of reaching almost equal percentages by 2018.

18. BTB's liquidity ratio was high (98.8%) and above the 30% requirement set by NBKR as of the end of 2014.<sup>26</sup> BTB's loans-to-deposit ratio as of the end of 2014 was 94.8% (2013: 77.4%), which was lower than the sector loans-to-deposit ratio of 109.7% (2013: 93.2%).<sup>27</sup> Because of the short-term nature of the bank's source of funding, longer-term external borrowings are required to be able to extend longer-tenor loans and to reduce maturity mismatches. Local currency loans dominate BTB's loan book, with foreign currency loans representing 38.4% of gross loans in 2014. Foreign exchange risks are hedged via the Currency Exchange Fund, local interbank swaps and back-to-back loans.<sup>28</sup> Additionally, BTB requires that any US dollar loans provided to MSMEs must have US dollar income to prevent a currency mismatch.

### Bai Tushum Bank Financial Highlights

(Som million)

Item	2012	2013	2014
Total assets	4,801	6,536	7,924
Gross customer loans	3,043	4,239	6,384
Total deposits from customers	89.7	351.7	717.2
Total shareholder equity	729.1	880.2	1066.2
Net income	36.3	62.0	201.4
Net interest margin	14.6%	12.1%	13.2%
Cost-income ratio	80.3%	82.6%	74.9%
Gross nonperforming loan ratio (>90 days), per ADB <sup>a</sup>	3.8%	2.6%	2.3%
Gross nonperforming loan ratio (>90 days), per BTB	1.3%	1.0%	0.8%

<sup>22</sup> Satisfactory loans: 2%, watch loans (past due up to 30 days): 5%, substandard loans (past due 30–60 days): 25%, doubtful loans (past due 60–90 days): 50%, and loss loans (past due over 90 days): 100%. NBKR Bulletin. 2014; and International Monetary Fund. 2014. *Country Report No. 14/2009: Kyrgyz Republic: 2014 Sixth Review Under the Three-Year Arrangement Under the Extended Credit Facility; Staff Report; and Press Release*. Washington, DC.

<sup>23</sup> Provisioning is higher in the event the som depreciates further.

<sup>24</sup> There is no prudential limit for top 20 group exposures.

<sup>25</sup> Others: Subordinated debt 1.7%, and non-interest bearing payables: 1.9%.

<sup>26</sup> Liquid assets to short-term deposits (demand deposits and term deposits with maturity less 30 days). The liquidity ratio is dependent on the lending season as well as the release of collateral deposits under maturing back-to-back loans where sizable amounts are accumulated on the correspondent accounts. These ratios can fall within a day when repayments have to be made.

<sup>27</sup> Includes money market funding.

<sup>28</sup> A back-to-back loan is a loan agreement between two commercial banks in which the currencies remain separate but the maturity date and interest rate remains fixed. BTB uses this to obtain local currency in exchange for US dollars but tenors are short, often up to 1 year. This instrument is used as a short-term swap in the Kyrgyz Republic.

Item	2012	2013	2014
Return on average equity	4.9%	7.7%	20.7%
Return on average total assets	0.8%	1.1%	2.8%
Capital adequacy ratio (%)	21.9%	19.8%	16.8%
US dollar–som average exchange rate	47.4	49.3	58.9

> = greater than, ADB = Asian Development Bank, BTB = Bai Tushum Bank.

<sup>a</sup> Includes loans on non-accrual status for which full payment is doubtful, based on the assessment of management, and restructured loans that would otherwise be past due or impaired.

Sources: Bai Tushum Bank and Asian Development Bank.

### III. THE ADB ASSISTANCE

#### A. The Assistance

19. The assistance consists of (i) a senior unsecured loan of up to \$10 million (a portion of which may be provided in som) in tranches with an overall tenor of 5 years, and (ii) capacity development technical assistance (TA) from an existing TA (in an amount to be determined) (footnote 2). The TA is expected to include assistance with product development for mobile banking and financial literacy training. As noted, BTB will use ADB's funds exclusively for onlending to MSMEs.

#### B. Implementation Arrangements

20. Monitoring of the project will be carried out by ADB.<sup>29</sup> BTB will provide ADB with financial reports at predetermined regular intervals and as requested, including (i) unaudited financial statements on a quarterly basis, (ii) audited financial statements on an annual basis, (iii) compliance certificates for financial covenants, (iv) reporting on the MSME loan portfolio, and (v) annual reporting on selected development indicators agreed between ADB and BTB. Annual reports on safeguards and social protection compliance will also be required.

#### C. Value Added by ADB Assistance

21. **Access to longer-tenor finance.** The loan will provide critically needed medium- and long-term funding to MSMEs in the Kyrgyz Republic, whose ability to access funds has been constrained by the country's low level of finance sector development—including the absence of a well-developed capital market—which limits availability of such funding. As a result, domestic credit provided by the banking sector was 16.3% of GDP and, as such, the country lags behind its peers (footnote 7). Moreover, MSMEs were particularly impacted by the 2010 political crisis and may experience negative impacts as a result of the current economic downturn, and will thus need continued funding to support future growth.

22. **Technical assistance.** ADB will be providing TA. The TA will help improve BTB's deposit mobilization and will include product development to increase BTB's outreach to remote villages and farmers through mobile banking and financial literacy programs. Financial literacy programs will help address potential over-indebtedness of household borrowers, thus promoting competitiveness and inclusiveness. Through close on-site monitoring and dialogue with BTB management and their shareholders, ADB will strengthen its relationship and develop inclusive business opportunities in the Central Asia region.

23. **Gender mainstreaming.** ADB will help strengthen BTB's outreach to women entrepreneurs and bolster internal policies pertaining to women. The project will be categorized as effective gender mainstreaming in design. Current labor force participation by women in the

<sup>29</sup> Details of Implementation Arrangements (accessible from the list of linked documents in Appendix 2).

Kyrgyz Republic is 56% compared with 80% for men, while the share of women employed in the non-agriculture sector remains low (43%).<sup>30</sup> Key gender designs include ensuring that women MSMEs benefit from at least 20% of the total loan portfolio and that BTB sponsors a network of women entrepreneurs.

#### D. Risks

25. The following are the expected risks and proposed mitigation measures:

26. **Political and economic conditions.** A three-party coalition government took office in April 2014 and elections are expected in 2015. Political fragility is fueled by interethnic tensions in the south, and foreign ownership of key economic assets such as the Kumtor gold mine. The economy remains vulnerable to internal politics and external shocks. GDP is projected to increase by 2% in 2016.<sup>31</sup> Economic growth has slowed because of recent political changes and events related to the Russian Federation and neighboring countries (including depreciation of the som), which could affect the performance of BTB.

27. **Bank growth phase.** BTB transitioned from a microfinance institution to a bank in 2012 and is implementing a comprehensive strategy to attract deposits and increase its customer base in order to expand its lending activities. Continued expansion of BTB's loan portfolio and an increase in the number of first-time borrowers that are extended credit could pose additional challenges for management and increase nonperforming loans. Due diligence has determined that management has a sound understanding of the risks associated with the increase in lending to MSMEs and has implemented measures to mitigate these risks, including (i) robust credit underwriting policies and procedures, (ii) investment in technology and an appropriate management information system, and (iii) ensuring that staff are appropriately qualified and trained.

28. **Market competition.** Since 2011, the MSME market in the Kyrgyz Republic has become increasingly competitive, particularly in the areas of trade, agriculture, and manufacturing. State-owned banks are active in MSME lending and may engage in subsidized lending. Nevertheless, BTB is expected to have a strategic advantage because of its tailored approach to the MSME sector, branch network, improved information technology platforms and, most importantly, BTB's history as a microfinance institution with a good, loyal client base, which gives it a comparative advantage in MSME service delivery. Based on its strategy, performance to date, and social interests, BTB is well-positioned to compete successfully in the MSME sector.

29. **Foreign currency risk.** Foreign exchange risks are hedged via the Currency Exchange Fund, local interbank swaps, and back-to-back loans (footnote 32). This gives BTB the ability to provide some financing to MSME clients. Additionally, US dollars will be lent only to those borrowers that have foreign currency income sources.<sup>32</sup> BTB's credit assessment processes of MSME subborrowers take currency mismatch risk into consideration; however, with the recent depreciation of the som, there may be increased pressure on the bank and its subborrowers. BTB carries out regular stress-testing based on different scenarios and foreign currency gaps.

<sup>30</sup> World Bank Data accessed 17 March 2015. <http://data.worldbank.org/indicator/SL.TLF.CACT.MA.ZS/countries>; and ADB. 2014. *Key Indicators for Asia and the Pacific 2014*. Manila.

<sup>31</sup> ADB. 2015. *Asian Development Outlook 2015: Financing Asia's Future Growth*. Manila.

<sup>32</sup> BTB has customers engaged in manufacturing, processing, and trade: food production, honey production, milk processing, and textiles with US dollar revenue streams that it lends to in US dollars.

## IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

### A. Development Impact, Outcome, and Outputs

30. **Impact.** The transaction will improve access to finance for MSMEs in the Kyrgyz Republic.

31. **Outcome.** The outcome is sustainable growth of BTB's MSME loan portfolio in urban and rural areas while retaining good asset quality and funding private business activities in the Kyrgyz Republic.

32. **Outputs.** Outputs include BTB's increased financial capacity to service MSMEs. BTB will provide access to longer-term funds for onlending to MSMEs which will result in an increased number of MSME accounts and volume of loans.<sup>33</sup> In addition, the ADB TA will help BTB to reach the underserved and, together with other international financial institutions, further develop mobile banking as a transaction mode. BTB will ensure that women MSMEs benefit from at least 20% of the total loan portfolio and account for least 39% of all loan accounts.

### B. Alignment with ADB Strategy and Operations

33. **Alignment with ADB strategy and operations.** Under its Midterm Review of Strategy 2020, ADB aims to strengthen its support for the finance sector by supporting the development of financial infrastructure, institutions, products, and services; and by promoting inclusive growth.<sup>34</sup> Through such initiatives, ADB will continue to assist in channeling the region's savings into the most productive investments, and continue to build the capacity of financial institutions by introducing international best practices. The proposed investment supports institutional and finance sector development through the deepening of the finance sector and the provision of funding for MSME onlending in urban and rural areas. Financial development will also be supported through capacity development TA, which will strengthen BTB's onlending capacity.

34. **Consistency with sector strategy and relevant ADB operations.** The Kyrgyz Republic's National Sustainable Development Strategy (NSDS) 2013–2017 aims to build a stable society and improve people's living standards through stable economic growth, an enabling business environment, and improved rule of law for private sector development.<sup>35</sup> Expanding access to finance and, specifically, long-term finance through private sector interventions in the banking sector is an ongoing priority for the country. ADB's country partnership strategy, 2013–2017 for the Kyrgyz Republic supports the NSDS. Expanding access to finance via banks is one of the objectives set forth in ADB's country operations business plan, 2014–2016 for the Kyrgyz Republic.<sup>36</sup> The project is consistent with the NSDS, country partnership strategy, and country operations business plan as it will broaden access to MSME finance for borrowers and support the development of finance sector products. Additionally, this facility complements the public sector Women's Entrepreneurship Development Project (financed by the Japan Fund for Poverty Reduction) and the Investment Climate and

<sup>33</sup> A new product will be developed specifically for women.

<sup>34</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

<sup>35</sup> National Council for Sustainable Development of the Kyrgyz Republic. 2013. *The Kyrgyz Republic 2013–2017 National Sustainable Development Strategy*. Bishkek.

<sup>36</sup> ADB. 2013. *Country Partnership Strategy: Kyrgyz Republic, 2013–2017*. Manila; ADB. 2013. *Country Operations Business Plan: Kyrgyz Republic, 2014–2016*. Manila.

Improvement Program in the Kyrgyz Republic to facilitate access to finance for MSMEs, particularly women MSMEs.<sup>37</sup>

## V. POLICY COMPLIANCE

### A. Safeguards and Social Dimensions

35. The investment is classified as category FI for impacts on the environment, involuntary resettlement, and indigenous peoples. BTB's business activities may have some adverse environmental impacts, and are unlikely to entail impacts on involuntary resettlement and indigenous peoples. ADB funds will not be used for financing subprojects classified as category A for the environment and categories A and B for involuntary resettlement and indigenous people. ADB funds will be used exclusively for onlending to MSMEs involved in agriculture, trade, and production. BTB will apply ADB's Prohibited Investment Activities List, and ensure that investments using ADB funds abide by applicable national laws and regulations, and comply with ADB's Safeguard Policy Statement (2009). The commitment and capacity of the borrower for environmental and social management have been assessed and BTB will enhance its environmental and social management system to ensure compliance with ADB requirements before ADB's first disbursement. BTB will confirm this in its periodic report to ADB and need not apply any other specific safeguard requirements.

36. BTB will comply with national labor laws and, pursuant to ADB's Social Protection Strategy, take measures to comply with the internationally recognized core labor standards.<sup>38</sup> BTB will report regularly to ADB on (i) its compliance with such laws, and (ii) the measures taken. Information disclosure and consultation with affected people will be conducted in accordance with ADB requirements. Proactive gender features are included in the project design to support the project's effective gender mainstreaming category.<sup>39</sup>

### B. Anticorruption Policy

37. BTB was advised of ADB's policy of implementing best international practices relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

### C. Investment Limitations

38. The proposed loan is within the medium-term, country, industry, and group exposure limits for nonsovereign investments and loan disbursements will be monitored over the availability period to ensure that amounts will only be disbursed if, at the time of such disbursement, the single investment exposure limit is complied with.

<sup>37</sup> ADB. 2013. *Grant Assistance Report: Women's Entrepreneurship Development Project*. Manila; and ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to the Kyrgyz Republic for the Second Investment Climate Improvement Program*. Manila.

<sup>38</sup> ADB. 2003. *Social Protection Strategy*. Manila (adopted in 2001).

<sup>39</sup> Summary Poverty Reduction and Social Strategy, Safeguards and Social Dimensions Summary, Financial Intermediary: Environmental and Social Management System Arrangement, and Gender Action Plan (accessible from the list of linked documents in Appendix 2.)

**D. Assurances**

39. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),<sup>40</sup> ADB will proceed with the assistance upon establishing that the Government of the Kyrgyz Republic has no objection to the assistance to BTB. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB.

**VI. THE PRESIDENT'S DECISION**

40. The President, acting under the authority delegated by the Board, has approved the loan of up to \$10,000,000 (a portion of which may be provided in an equivalent amount of som) from ADB's ordinary capital resources to Bai Tushum Bank for Broadening Access to Finance in the Kyrgyz Republic, and hereby reports this action to the Board.

01 June 2015

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<sup>40</sup> ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the Project is aligned with:</b>			
Improved access to finance for MSMEs in the Kyrgyz Republic. (National Sustainable Development Strategy, 2013)*			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting</b>	<b>Risks</b>
<b>Outcome</b>  Growth of BTB's MSME loan portfolio in urban and rural areas sustained	By 2021  a. The MSME portfolio of BTB grows to 50% of its total loan portfolio <sup>a</sup> (2014 baseline: 40%)  b. Average nonperforming loan <sup>b</sup> ratio for MSMEs remains no more than 6% per annum between 2014 and 2022 (2014 baseline: an average nonperforming loan ratio of 2.84% between 2012 and 2014)	a-b. BTB's annual financial statements  a-b. ADB's annual monitoring report on growth of the loan portfolio, including segmentation	Political and economic uncertainty  Adverse changes in market conditions  MSME sector is no longer a priority sector of growth
<b>Outputs</b>  1. Capacity to service MSMEs increased	1a. Tenor of loans increases to 2.5 years by 2020. (2014 baseline: 2.0 years)  1b. Increase in new loan accounts to 14,500 by 2020 (2014 baseline: 9,500)  1c. Increase in the number of accounts by women MSMEs to 5,655 (or 39% of total accounts) by 2020 (2014 baseline: 3700) <sup>c</sup>  1d. \$10 million made available for MSMEs between 2015 and 2018 (2014 baseline: N/A)  1e. No less than 20% of \$10 million will be made available to women MSMEs <sup>c</sup> (2014 baseline: N/A)	1-2. BTB's annual financial statements  1-2. ADB's annual monitoring report	Insufficient demand for loans from MSMEs  BTB does not use capacity development TA effectively
2. BTB's offers of new products to its borrowers increased	2a. Two new financial products launched by 2020 (of which one specifically for women MSMEs) (2014 baseline: N/A)  2b. TA for product development is implemented (2014 baseline: N/A)		
<b>Key Activities with Milestones</b>			
Outputs 1 1.1 ADB executes loan facility agreement with BTB by August 2015 1.2 Senior loan of up to \$10 million is provided to BTB			

1.3 BTB operationalizes funding proceeds to MSMEs

Output 2

2.1 ADB provides technical assistance for MSME capacity building

**Inputs**

ADB (loan): \$10 million

ADB = Asian Development Bank; BTB = Bai Tushum Bank; MSMEs = micro, small and medium-sized enterprises; TA = technical assistance.

\* National Council for Sustainable Development of the Kyrgyz Republic. 2013. *The Kyrgyz Republic 2013–2017 National Sustainable Development Strategy*. Bishkek.

<sup>a</sup> Includes borrowing by new clients and borrowing for new loans established currently by BTB. Bank client means any person and/or enterprise which is incorporated in the Kyrgyz Republic that employs fewer than 200 employees and has annual sales of less than \$5,000,000 or the equivalent thereof.

<sup>b</sup> Ninety days past due.

<sup>c</sup> Women MSMEs will be defined as follows: (i) at least 50% of enterprise ownership is controlled by women, (ii) at least 60% of senior managers are women, or (iii) at least 50% of the employees of the enterprise are women.

Source: Asian Development Bank.



**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=48348-001-3>

1. Sector Overview
2. Ownership, Management, and Governance
3. Details of Implementation Arrangements
4. Contribution to the ADB Results Framework
5. Financial Analysis
6. Country Economic Indicators
7. Summary Poverty Reduction and Social Strategy
8. Safeguards and Social Dimensions Summary
9. Financial Intermediary: Environmental and Social Management System Arrangement

**Supplementary Documents**

10. Gender Action Plan
11. Bai Tushum Bank Financial Statements
12. Bai Tushum Bank Organizational Chart
13. Bai Tushum Bank Members of the Board Personnel