



# Report and Recommendation of the President to the Board of Directors

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Project Number: 53161-001  
September 2021

## Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant Republic of Uzbekistan: Financial Markets Development Program

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Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 16 August 2021)

Currency unit	–	sum (SUM)
SUM1.00	=	\$0.00009372
\$1.00	=	SUM10,669.20

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
CBU	–	Central Bank of Uzbekistan
COVID-19	–	coronavirus disease
CPS	–	country partnership strategy
DMO	–	debt management office
DSA	–	debt sustainability analysis
GDP	–	gross domestic product
IMF	–	International Monetary Fund
IOSCO	–	International Organization of Securities Commissions
KYC	–	know your customer
MOF	–	Ministry of Finance
PFM	–	public financial management
SAMA	–	State Assets Management Agency
SOE	–	state-owned enterprise
TA	–	technical assistance
UCSD	–	Uzbekistan Central Securities Depository
UFRD	–	Uzbekistan Fund for Reconstruction and Development
UZRSE	–	Uzbekistan Republican Stock Exchange

## **NOTE**

In this report, “\$” refers to United States dollars.

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## CONTENTS

	<b>Page</b>
PROGRAM AT A GLANCE	
I. THE PROPOSAL	1
II. PROGRAM AND RATIONALE	1
A. Background and Development Constraints	1
B. Policy Reform, ADB's Value Addition, and Sustainability	5
C. Expected Outcome of the Reforms	8
D. Development Financing Needs and Budget Support	8
E. Implementation Arrangements	9
III. ATTACHED TECHNICAL ASSISTANCE	10
IV. DUE DILIGENCE	10
V. ASSURANCES	12
VI. RECOMMENDATION	12
APPENDIXES	
1. Policy Design and Monitoring Framework	13
2. List of Linked Documents	19
3. Development Policy Letter	20

## PROGRAM AT A GLANCE

1. Basic Data		Project Number: 53161-001	
Project Name	Financial Markets Development Program (Subprogram 1)	Department/Division	CWRD/CWPF
Country	Uzbekistan	Executing Agency	Ministry of Finance
Borrower	Uzbekistan		
Country Economic Indicators	<a href="https://www.adb.org/Documents/LinkedDocs/?id=53161-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=53161-001-CEI</a>		
Portfolio at a Glance	<a href="https://www.adb.org/Documents/LinkedDocs/?id=53161-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=53161-001-PortAtaGlance</a>		
2. Sector		ADB Financing (\$ million)	
✓ Finance	Finance sector development		100.00
		Total	100.00
3. Operational Priorities		Climate Change Information	
✓ Accelerating progress in gender equality		GHG reductions (tons per annum)	0
✓ Strengthening governance and institutional capacity		Climate Change impact on the Project	Low
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.b		Some gender elements (SGE)	✓
SDG 5.c			
SDG 17.3			
		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization:		Complex	
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		100.00	
Sovereign Programmatic Approach Policy-Based Lending (Concessional Loan): Ordinary capital resources		100.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		100.00	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-7) in the amount of \$500,000.			
Currency of ADB Financing: US Dollar			

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Financial Markets Development Program, and (ii) a proposed policy-based loan (PBL) to the Republic of Uzbekistan for subprogram 1 of the Financial Markets Development Program. The report also describes proposed technical assistance (TA) for Supporting the Financial Markets Development Program, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The proposed program will support demand and supply measures to broaden and deepen the financial system in Uzbekistan to facilitate effective intermediation. It will support policy, regulatory, and institutional (including market infrastructure) reforms necessary to create an enabling environment for competitive financial markets in line with the government's Strategy on Actions for Further Development of Uzbekistan (2017–2021) and follow-on Roadmap of Reforms (2019–2021),<sup>1</sup> Asian Development Bank (ADB) country partnership strategy (CPS) for Uzbekistan, 2019–2023,<sup>2</sup> and the ADB country operations business plan for Uzbekistan, 2021–2023.<sup>3</sup> The programmatic approach, comprising two subprograms, will help sequence reforms over a 4-year timeframe (2019–2023) and provide flexibility to incorporate changes if warranted (para. 19). TA attached with the program's concept paper approval in 2019 supported reform measures from 2019 to 2021.<sup>4</sup> With its emphasis on creating an enabling environment for financial market development, the program design is robust and fits well with the country's needs as a growing and economically diversifying economy. The attached TA will assist in implementing the program.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. The Government of Uzbekistan has accelerated its transition toward a market economy with the adoption of the Strategy on Actions for Further Development of Uzbekistan (2017–2021) and follow-on Roadmap of Reforms (2019–2021) (footnote 1). Both the strategy and the road map recognize the central role played by the banking sector and financial markets in fostering this transition. The Roadmap of Reforms tasks the government with modernizing and developing financial markets to better address the financing needs of the real economy, which is moving away from a state-led and state-dominated economy towards a market-oriented, private sector-led model.<sup>5</sup> Underdeveloped financial markets have contributed to the ineffective mobilization of savings with gross domestic savings at 31% of gross domestic product (GDP), which is lower than regional peers such as Kazakhstan (42% of GDP). The introduction of market-based instruments, backed by a sound enabling environment for competitive financial markets, will mobilize private sector financing and help the private sector become the driver of sustainable economic growth.

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<sup>1</sup> Government of Uzbekistan. 2017. Strategy on Actions for Further Development of Uzbekistan (2017–2021). *Presidential Decree No. 4947*. Tashkent. 7 February; and Government of Uzbekistan. 2019. Roadmap of Reforms (2019–2021). *Presidential Decree No. 5614*. Tashkent. 8 January.

<sup>2</sup> ADB. 2019. [Country Partnership Strategy: Uzbekistan, 2019–2023—Supporting Economic Transformation](#). Manila.

<sup>3</sup> ADB. 2020. [Country Operations Business Plan: Uzbekistan, 2021–2023](#). Manila.

<sup>4</sup> ADB. 2019. [Technical Assistance to the Republic of Uzbekistan for Preparing the Financial Markets Development Program](#). Manila.

<sup>5</sup> The Government of Uzbekistan's issuance of \$1 billion of Eurobonds on 13 February 2019 on the London Stock Exchange reflects the confidence exhibited by investors in the country's economic fundamentals, and the government's political will to carry out its reform program. It was preceded by the country's first sovereign credit rating by S&P Global Ratings, Fitch Ratings (BB-), and Moody's Investors Service (B1) in December 2018–February 2019.

4. Uzbekistan maintained a record of sound macroeconomic management, achieving average GDP growth of 6.8% during 2010–2019, driven by growth in industry and services, the private sector, commodity exports, and foreign investment. A conservative fiscal and debt policy has led to a low risk of debt stress, even with the impacts of the coronavirus disease (COVID-19) (para. 22). With the global economic recession brought on by COVID-19, Uzbekistan's GDP growth for 2020 declined to 1.6% in 2020,<sup>6</sup> from a pre-COVID-19 forecast of 6%, but growth is projected to rebound to 5% in 2021. Uzbekistan's merchandise exports, which grew at 20.2% in 2019, contracted by 15.4% in 2020, but are projected to grow at 19.8% in 2021.<sup>7</sup> The fiscal deficit widened to 4.4% in 2020 from 3.9% in 2019 with lower revenues and increasing expenditures, including countercyclical spending, and is projected to reach 5.5% in 2021. Global risk aversion increased the cost to Uzbekistan of accessing global financial markets. The yield to maturity on Uzbekistan's sovereign bond increased by 160 basis points from May 2019 to March 2020.<sup>8</sup> Although the yield to maturity declined by almost 3% from March 2020 to April 2021, it is evident that volatility pervades in global financial markets. As a result, development of robust and competitive domestic financial markets is even more critical as an indispensable tool for mobilizing private investment and minimizing the impact of such external shocks. The program will aid in the COVID-19 recovery phase through subprogram 1 reforms that facilitate mobilization of savings such as on-boarding of new retail investors through simplified "know your customer" (KYC) procedures with biometric verification. The government is aware of the need to implement crucial reforms so that domestic financial markets can better intermediate savings and investments to drive sustainable economic growth, and help mitigate impact of exogenous shocks.

5. ADB's Strategy 2030 prioritizes the development of the finance sector and financial markets in order to support sustainable economic development by creating an enabling environment for private investment.<sup>9</sup> Private investment is also identified as a key driver of economic growth and a source of employment generation during Uzbekistan's economic transition, and a strategic area for ADB's support in the CPS (footnote 2). The program will not only support private sector expansion but also contribute to the operational priorities of (i) strengthening governance and institutional capacity through specific institutional strengthening reforms, and (ii) accelerating progress in gender equality through reforms that enhance female participation in the governance of financial markets.

6. **Bank-dominated finance sector with ineffective intermediation.** Uzbekistan's finance sector, dominated by banks, does not effectively play its intermediation role due to constrained mobilization of long-term financial resources. The economy is overly reliant on bank financing, with banking sector assets accounting for 63.1% of GDP as of January 2021.<sup>10</sup> Until 2019, the state-owned banks pursued government-directed lending programs at below-market rates, crowding out market pricing, and primarily lending to state-owned enterprises (SOEs). The country has 32 commercial banks; 13 of which are state-owned banks, and account for more than

<sup>6</sup> International Monetary Fund (IMF). 2021. *World Economic Outlook: Managing Divergent Recoveries*. Washington, DC.

<sup>7</sup> Gold exports constituted 38.2% of exports in 2020, followed by industrial products (18.4%) and services (17.6%). Other major commodity exports—natural gas, cotton, and copper—have been affected by the fall in demand and prices. Government of Uzbekistan. 2020. *Ministry of Finance Newsletter No. 10*. Tashkent.

<sup>8</sup> The Government of Uzbekistan issued \$1 billion of Eurobonds on 13 February 2019 at the London Stock Exchange. The first tranche is due in February 2024 and the second tranche is due in February 2029.

<sup>9</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

<sup>10</sup> Central Bank of Uzbekistan. 2021. *Statistical Bulletin*. Tashkent.

85% of banking sector capital and assets.<sup>11</sup> Their direct involvement in the financing of SOEs has disincentivized provision of commercial services to the private sector.<sup>12</sup> With long-term government funding steadily declining since 2019, customer deposits are insufficient to support long-term financing because a large share of customer deposits continue to be of short duration. The decline in long-term government funding to banks is evident from the transfer of \$4.3 billion of long-term Uzbekistan Fund for Reconstruction and Development (UFRD)-funded loans to SOEs from the balance sheets of state-owned banks to UFRD, and the swap by UFRD of \$1.5 billion in loans for equity participation in state-owned banks.<sup>13</sup>

7. **Underdeveloped money and capital markets.** The interbank money market is small and inactive. State-owned banks receive subsidized funds from the state, while the 19 private banks rely mostly on deposit funding. Money market liquidity is not managed effectively in the absence of open market operations and the lack of appropriate instruments (such as repurchase agreements and currency swaps), transactions, and pricing mechanisms.<sup>14</sup> In the absence of market-based benchmarks, the refinancing rate of the Central Bank of Uzbekistan (CBU) is regarded as the sole money market price indicator, although there are practically no transactions with the CBU at this rate (14% as of 15 September 2021). A well-functioning money market is the cornerstone of resilient financial markets and forms the basis for enhanced liquidity, pricing, and tenor extension of financial market instruments.

8. Uzbekistan's domestic capital markets do not play a significant role in financial intermediation and resource mobilization. The existing capital market legal framework is fragmented, limited in scope, and does not align with international standards.<sup>15</sup> The Securities Market Law is frequently supplemented by presidential and/or ministerial decrees to cover gaps in market regulation. The Department of Capital Markets Development at the Ministry of Finance (MOF) is the state regulator for the nonbank financial markets. The Uzbekistan Republican Stock Exchange (UZRSE) lacks depth, both in the number of investors and the number of companies raising capital. Market capitalization of the UZRSE (\$5.23 billion) accounted for only about 9.4% of the country's GDP in January 2021; it has 145 listed companies, and daily trading volume of about \$200,000, reflecting both its small-scale and low-trading liquidity.<sup>16</sup> The UZRSE's market capitalization as a percentage of GDP is below its regional peers (Kazakhstan 21%, Poland 27%, and the Russian Federation 39%). Fewer than 200,000 individual investors (less than 0.6% of the population) have a stock investing account. The absence of a centralized KYC procedure and cumbersome customer onboarding requirements impede participation of new retail investors in the financial markets. Taxation of dividends also discourages investor participation because it reduces the return available to investors. The state owns about 86% of the shares of listed companies. The absence of women on company boards reduces investment efficiency, earnings

<sup>11</sup> More than half of total loans are shared by three state-owned banks, i.e., the National Bank of Uzbekistan (28.5%), Uzpromstroybank (14.8%), and Ipoteka Bank (10.2%). Standard & Poor's Global Ratings. 2019. *Bank Ratings in Uzbekistan*. Moscow. 5 September.

<sup>12</sup> Of the SUM165 trillion credit stock in 2018 (51% of GDP), 58% was preferential credit (directed lending) at the average interest rate of 8%, while 42% was commercial credit at a 22% interest rate. IMF. 2019. Republic of Uzbekistan: Article IV Consultation Press Release and Staff Report. *IMF Country Report*. No.19/129. Washington, DC.

<sup>13</sup> Fitch Ratings. 10 April 2020. *Uzbekistan Rating Action Report*.

<sup>14</sup> A repurchase agreement is a form of short-term borrowing in government securities, usually on an overnight basis, for liquidity management. A currency swap is the exchange of principal and interest in different currencies to mitigate the risk of unwanted interest rate fluctuations.

<sup>15</sup> International Organization of Securities Commissions (IOSCO). May 2017. *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*. Madrid.

<sup>16</sup> Republican Stock Exchange "Toshkent". Market Overview.

[https://www.uzse.uz/system/analytics/pdfs/000/000/100/original/market\\_overview\\_january\\_2021\\_eng.pdf?1613970158](https://www.uzse.uz/system/analytics/pdfs/000/000/100/original/market_overview_january_2021_eng.pdf?1613970158) (accessed June 2021).



quality, and market performance.<sup>17</sup> A long-term financial market development strategy to guide direction and implementation of financial market development reforms is also absent, with no forum that enables key financial market agencies to coordinate their efforts.

9. **Largely inactive and illiquid debt market.** Uzbekistan's government bond market is primarily short-dated. As of June 2021, outstanding treasury bills and bonds totaled SUM3,227 billion (\$320 million). Volume and liquidity in longer-term government bonds is restricted with only three issuances at a maximum of 3 years maturity. The government bond market does not fulfill its role in setting benchmark pricing because of irregular government debt management practices arising from a debt management office (DMO) that does not yet function as a properly empowered treasury operation for government bond market development. The DMO is responsible for debt management at MOF; it has insufficient structural capacity in terms of staffing and does not possess a centralized database for effective cash management and planning. The current operating framework of the government bond market system does not promote competitive bidding. Auctions of government bonds are not conducted based on a pre-announced auction calendar, which prevents investors from effectively preparing for each new issue. The auction cutoff yields follow the policy rate (14% as of 15 September 2021), suggesting that bidding is not market-based, and hindering formulation of a credible government bond yield curve and liquid bond market. The absence of an effective government bond yield curve impedes the appropriate pricing of corporate bonds, reducing their attractiveness to both issuers and investors. The corporate bond market is subsequently small and narrow, constituting less than 1% of GDP, with only seven corporate bonds outstanding for an aggregate nominal value of SUM190 billion (\$20 million) as of January 2021. Most of these bonds were placed privately and are therefore not listed.

10. **Constrained institutional investor participation.** On the demand side, major institutional investors (such as insurance companies and pension funds) have a limited role in financing government and corporate bonds because of a lack of investible funds. Insurance companies prefer deposits and real estate because their investment horizon is limited to the average duration of their liabilities (i.e., insurance products and policies), which averages 12 months, even for life insurance products. The national pension fund is off-balance sheet and a pay-as-you-go defined benefit pension system operated by MOF. The pension fund has limited investment capability with only about SUM6 trillion (\$563 million) of "free funds". The major investment destination is nine state-owned commercial banks, with investment in the form of short-term, 6-month bank deposits, thereby limiting the contribution to financial market development. Institutional investors promote the growth of market capitalization in the equity market, and their participation across the maturity spectrum of the government bond market yield curve is critical to support market development. A diverse investor base also lowers debt cost and volatility in market yields.

11. **Fragmented financial market infrastructure.** The fragmented market infrastructure results in high transaction costs for investors because infrastructure for trading of listed equities and corporate bonds, government bonds and foreign currencies, and unlisted securities is not harmonized, with each having its own regulator and technology platform. Listed equities and corporate bonds trade on the UZRSE, which is regulated by MOF. For the UZRSE, trades are settled on the Uzbekistan Central Securities Depository (UCSD), while the National Bank for Foreign Economic Activity of Uzbekistan acts as the settlement bank. Government bonds and

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<sup>17</sup> Female board representation has shown to improve performance (e.g., return on assets, return on equity, and earnings per share), while reducing volatility. D. A. Carter, B. J. Simkins, and W. G. Simpson. 2003. Corporate governance, board diversity, and firm value. *Financial Review*, 38(1), 33–53.; Y. Shin et al. 2020. Female directors on the board and investment efficiency: evidence from Korea. *Asian Business & Management*.19, 438–478.

foreign currencies trade on the Uzbekistan Republican Currency Exchange, which is regulated by the CBU, with the CBU acting as the settlement bank. Unlisted securities trade on the Elsis Savdo, an over-the-counter trading platform. The post-trading market infrastructure does not comply with International Organization of Securities Commissions (IOSCO) risk management principles because transactions at the UZRSE are settled at a commercial bank (i.e., the National Bank for Foreign Economic Activity of Uzbekistan) instead of the CBU. Post-trade settlement through direct use of the CBU real-time gross settlement system for all securities enables delivery versus payment, which is critical to address system incongruencies and shift the market's post-trading infrastructure towards international risk management standards as prescribed by the Bank for International Settlements–IOSCO principles for financial market infrastructures. The reorganization of pre-trade and post-trade infrastructure into consolidated, shared or linked platforms lower transactions costs for participants and investors through economies of scale.

## **B. Policy Reform, ADB's Value Addition, and Sustainability**

12. The program proposes to introduce reform measures that deepen and broaden Uzbekistan's financial markets by (i) developing the public debt management framework to promote a more liquid government bond market; (ii) enhancing institutional investor demand by broadening, deepening, and diversifying the investor base; (iii) supporting the money markets; (iv) developing critical market infrastructure including surveillance systems, consolidating trading systems, and enhancing post-trading systems; and (v) enhancing the supply of alternative financial instruments such as exchange-traded funds. Consultations with the government identified the following reform areas.

13. **Market facilitation enhanced.** Reforms in this area support more efficient mobilization and allocation of resources in the economy by defragmenting and streamlining for efficient market infrastructure, as well as strengthening the capital market legal framework. Subprogram 1 actions include (i) an approved capital market development strategy that is funded by the government to guide direction and implementation of capital market reforms by MOF, CBU, UCSD, the State Assets Management Agency (SAMA), UZRSE, and the Uzbekistan Republican Currency Exchange under the leadership of the advisor to the President of Uzbekistan, which ensures the program is an integral part of a government-owned long-term development strategy; (ii) adoption of a time-bound road map for integration of trading platforms and reorganization of UCSD including consolidation of all capital market assets (shares, government and corporate bonds, equities, and other financial instruments) to streamline efficient market infrastructure through reorganization of pre-trade and post-trade infrastructure into consolidated, shared, or linked platforms to lower transactions costs for participants and investors through economies of scale; (iii) adoption of gender mainstreaming policies for SAMA to enhance female board representation by ensuring a minimum of one female director on the supervisory board of at least 10 publicly listed SOEs; and (iv) adoption of an approved gender policy by UZRSE that includes minimum requirements for female representation in management as well as equal remuneration and training across the organization. Subprogram 2 will include (i) preparation and endorsement of a draft Capital Markets Law to the Parliament to consolidate fragmented capital markets-related laws and regulations; (ii) implementation of the road map for integration of trading platforms and reorganization of UCSD by critically providing UCSD access to the real-time gross settlement system at the CBU, thereby making CBU the settlement bank for corporate securities; (iii) application of delivery versus payment for settling trades and processing corporate transactions at the UCSD to streamline efficient post-trading market infrastructure; and (iv) installation of electronic market surveillance system at UZRSE to prevent manipulative and illegal trading practices in the financial markets, thereby ensuring market integrity.

14. **Demand measures enhanced.** Subprogram 1 supported the development of the demand side of the market as follows: (i) a draft public debt law was prepared and endorsed to the Cabinet of Ministers by MOF, and will serve as the legislative foundation to facilitate government bond market development through an effective public debt management framework; (ii) an e-KYC legislative framework was established (a Presidential Resolution for the introduction of a digital economy and e-government, and a Presidential Decree on Digital Uzbekistan 2030<sup>18</sup> were approved by the office of the President) to facilitate onboarding of new retail investors and enhance retail investor demand through a digital identification verification system for remote account opening; (iii) a revised staffing plan was approved to strengthen DMO's debt management expertise and capacity, which is critical to effectively implement the public debt management framework and promote government bond market development; (iv) the dividend tax rate was reduced to encourage investor participation and enhance investor demand for corporate securities, because the tax measure increases the return available to investors; and (v) a draft law on insurance activity was submitted to Parliament to facilitate insurance market development through effective regulatory mechanisms and prudential supervision. The law provides the legislative foundation to promote the insurance industry's growth and stability that will subsequently encourage investor demand through issuance of investment guidelines. Subprogram 2 will (i) operationalize the DMO staffing plan; (ii) enhance institutional investor demand by establishing a pension fund development and regulation agency, and issue rules and regulations (paid-up capital and asset investment) for the insurance sector; (iii) build upon the e-KYC legislative framework and issue fintech application regulations to allow retail investor access to the capital market through application program interfaces for all types of capital market assets to enhance retail investor demand; and (iv) issue an auction calendar to help primary market participants effectively bid at auctions, and implement consolidation of fragmented issues of government bonds into sizable benchmark issues of government bonds to increase liquidity in the government bond market under the public debt management framework provided by the public debt law.

15. **Supply measures enhanced.** To strengthen the supply side of the market, subprogram 1 (i) introduced money market instruments (such as repurchase agreements and currency swaps) to develop a foundation for resilient financial markets by ensuring well-functioning money markets with enhanced liquidity, pricing, and tenor of financial market instruments; and (ii) issued revised equity and corporate bond market listing and delisting rules to facilitate and increase the number of listings to broaden the financial markets. The listing rules comprise various criteria and minimum standards established by the UZRSE (such as disclosure requirements, minimum stockholder's equity, and a minimum share price) to allow membership and trading of listed shares of a company at the UZRSE. Subprogram 2 will (i) complete the initial public offerings on the UZRSE of at least three SOEs through synergies achieved with the e-KYC process to broaden and deepen the capital markets by increasing the number of listings; and (ii) introduce alternative asset classes, such as exchange-traded funds and real estate investment trusts, to build upon the foundation of market development and expand the investor base.

16. **ADB's value addition.** The value addition of ADB stems from its extensive experience in assisting in designing and implementing reforms to facilitate financial market development reforms across developing member countries. The program has utilized this experience in Uzbekistan and (i) facilitated the identification of key reforms based on international best practices

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<sup>18</sup> Government of Uzbekistan. 2020. On approving the Digital Uzbekistan Strategy 2030 and Measures for its Effective Implementation. *Presidential Decree No. 6079*. Tashkent. 5 October; and Government of Uzbekistan. 2020. On measures for the widespread introduction of the digital and E-government. 2020. *Presidential Resolution No. 4699*. Tashkent. 28 April.

in key areas of financial market development; (ii) provided operational support to implement complex reforms (such as insurance, pension funds, market infrastructure) through targeted TA;<sup>19</sup> (iii) created synergies with ADB's sector-specific support to facilitate timely implementation of selected policy actions under the program; and (iv) coordinated effectively with other development partners to provide advice on a unified reform package to the government.

17. **Lessons.** The program also incorporates lessons from the Independent Evaluation Department's special evaluation study to ensure it is implemented effectively.<sup>20</sup> The program has (i) focused on a limited number of impactful policy actions; (ii) ensured ownership of the reforms by relevant key stakeholders thorough comprehensive consultations (involving intensive one-on-one meetings and joint stakeholder wrap-up meetings) to diagnose issues;<sup>21</sup> (iii) helped facilitate, jointly with all stakeholders, formulation of the government's capital market development strategy to ensure reform sustainability is anchored to the government's capital market development strategy; and (iv) pursued a holistic approach to ensure inclusion of insurance and pension areas and their links to financial market development. The approval of the government's capital market development strategy was done at the Presidential level to transcend different levels of vested interests and strengthen government ownership as well as commitment. The advisor to the President of Uzbekistan has been appointed to lead the strategy implementation and coordination amongst the key agencies. The government's capital market development strategy therefore effectively institutionalizes coordination amongst all key stakeholders and represents the key for reform sustainability.

18. **Coordination among development partners.** ADB is closely coordinating with other development partners to ensure synergies and complementarity. The World Bank's \$500 million Sustaining Market Reforms development policy operation (approved in June 2019), and \$200 million supplementary development policy financing (approved in April 2020) support Uzbekistan's economic reforms and transition to a market economy by increasing the role of markets and the private sector in the economy. The World Bank programs support a new Banking Law that gives sufficient powers to the CBU to conduct effective oversight and enforcement, establish a comprehensive and transparent licensing framework, and strengthen corporate governance and transparency requirements for commercial banks. In 2019, the United Nations Development Programme (UNDP) conducted a situational analysis of Uzbekistan's financial markets that revealed a weak legal and regulatory framework, low market liquidity, and absence of major financing tools.<sup>22</sup> The UNDP study served as the basis for development of the capital market development strategy that was prepared with support from the European Bank for Reconstruction and Development (EBRD) (the equity market portion) and ADB (the bond market portion). In 2021–2022, EBRD is providing dedicated resident professional experts to support implementation of the capital market development strategy in collaboration with ADB. In 2019, the United States Treasury approved a \$1 million grant for developing budget planning and improving public debt management practices at MOF that will facilitate government bond market development. The program builds on this foundation of solid debt management by developing the government bond market through support for realization of a market-based government bond market yield curve. ADB is also collaborating with the International Monetary Fund (IMF). The IMF is expected to design and approve a public debt management TA in early 2022 in close

<sup>19</sup> Attached Technical Assistance (accessible from the list of linked documents in Appendix 2).

<sup>20</sup> Independent Evaluation Department. 2008. *Special Evaluation Study on ADB Assistance for Domestic Capital Market Development*. Manila: ADB.

<sup>21</sup> Two national stakeholder and dissemination workshops for designing the financial market development strategy were held during program formulation, with 112 registered participants across 22 different organizations.

<sup>22</sup> United Nations Development Programme. 2017. *Support to Investment Climate Improvement (TA) 2017–2019*. Tashkent.

coordination with ADB and the United States Department of the Treasury to enable strong complementary efforts in government bond market development.

### **C. Expected Outcome of the Reforms**

19. The program is aligned with the following overarching development objective: a well-functioning financial system that supports basic capital and investment needs and the country's long-term economic objectives.<sup>23</sup> Development of financial markets will contribute towards achieving this objective by creating efficiencies and innovations to ensure the balanced development of the finance sector through diversification of a predominantly bank-based system of financial intermediation, expansion of the sources of financial intermediation, reduction of financing costs by stimulating competition, and enhancement of the financial market's contribution to meeting the financing requirements of a growing economy. The expected outcome of the reforms will be: capacity and size of the financial markets augmented. The outcome is supported by three reform areas: (i) market facilitation enhanced, (ii) demand measures enhanced, and (iii) supply measures enhanced. The reforms under subprogram 1 establish a solid foundation for financial market development featuring critical changes in legal, institutional, and human resource structures by focusing on supporting the money market, strengthening DMO's debt management expertise and capacity, developing the public debt management framework, and enhancing retail investor demand through tax incentives as well as simplified KYC. Subprogram 2 builds on this financial market development foundation by catalyzing institutional investor (insurance and pension sector) demand to support development of the government bond market yield curve and increasing the supply of alternative financial instruments such as exchange-traded funds to diversify the financial markets; this can only take place if the critical prerequisites under the previous subprogram are in place. A programmatic approach is needed because the structural reforms require a long-term horizon to be implemented effectively. Understanding capacity constraints while designing the reforms is also important, which makes sequencing of reforms critical. For example, streamlined efficient market infrastructure (such as the integration of the trading platforms) in the program requires sufficient preparatory and implementation time. It is therefore critical that the reforms are properly identified and sequenced over two subprograms as described in this paragraph. A programmatic approach is ideal for chronologically sequencing the reforms in a multiyear framework. The proposed reforms of standards and procedures conform to best practices, including those promulgated by the IOSCO.<sup>24</sup>

### **D. Development Financing Needs and Budget Support**

20. Based on the development financing requirements of the program, ADB proposes to provide a \$200 million policy-based loan to finance two subprograms through the programmatic approach. For subprogram 1, the government has requested a concessional loan of \$100 million from ADB's ordinary capital resources to help finance the program. The loan will have a 25-year term, including a grace period of 5 years; an interest rate of 2% during the grace period and thereafter; and such other terms and conditions set forth in the draft loan agreement. The draft development policy letter is in Appendix 3.

21. **Uzbekistan's development financing needs.** According to the macroeconomic projections from IMF's 2021 Article IV report,<sup>25</sup> the government's financing requirement (overall fiscal deficit) is projected at \$3,359 million (5.5% of GDP) in 2021. As detailed in Table 1, this will

<sup>23</sup> Government of Uzbekistan. 2019. *Roadmap of Reforms of Uzbekistan, 2019–2021*. Tashkent.

<sup>24</sup> The design and monitoring framework is in Appendix 1.

<sup>25</sup> Country Statistics; IMF. 2021. [Republic of Uzbekistan. Article IV Consultation – Press Release and Staff Report](#). *IMF Country Report* No. 21/85. April. Washington, DC.

be mainly externally financed (\$2,653 million) through borrowings from international financial institutions, bilateral creditors, and Eurobonds issuance. The remainder (\$706 million) will be domestically financed through banking system, domestic securities, and privatization proceeds.

**Table 1: Financing Needs in 2021**  
(\$ million)

Item	Amount
Gross financing requirement	3,359.0
Gross domestic financing <sup>a</sup>	706.0
Gross external financing	2,653.0
ADB's programmed policy-based loans	
<i>Financial Markets Development Program (subprogram 1)</i>	100.0
<i>Small and Medium-Sized Enterprises Development Program (subprogram 1)</i>	100.0
World Bank (Development Policy Operations)	500.0
Japan International Cooperation Agency	150.0
Eurobonds	850.0
Other support from IFIs and bilateral sources	953.0

ADB = Asian Development Bank, IFI = international financial institution.

<sup>a</sup> Deposits held at the central bank and the state-owned banks (\$500 million), domestic securities (\$187 million), and privatization proceeds (\$19 million).

Source: International Monetary Fund and Asian Development Bank estimates.

22. **Debt sustainability.** ADB's March 2021 public debt sustainability analysis (DSA) indicates sustainable public debt and a low risk of debt stress, even under the post-COVID-19 scenario.<sup>26</sup> The IMF's DSA under the April 2021 Article IV report (footnote 26) supports this conclusion: the debt-to-GDP ratio (based on total public and publicly guaranteed debt, comprising public domestic and external debt and public guarantees) increased from 29.3% in 2019 to 37.8% in 2020, and is projected by the IMF to reach 42.1% in 2021 and nearly 44% by 2023. ADB's DSA shows that proposed ADB loans of \$200 million represent less than 1% of Uzbekistan's outstanding external debt stock of \$20.6 billion at end of 2020. Additional lending of \$650 million by the World Bank and the Japan International Cooperation Agency would add another 3% to the public debt stock. According to ADB's DSA, the public debt–GDP ratio (comprising public external and domestic debt and public guarantees) is projected to increase from 29.3% in 2019 to 36.4% in 2020 and 42.9% in 2021, but then steadily decline from 42.6% in 2022 to 41.0% by 2024. This analysis substantiates that Uzbekistan has low risk of debt distress and debt sustainability will not be impaired, because total public debt, including guarantees, remains moderately low. Public debt mainly consists of long-term loans from international financial institutions, which keeps borrowing costs low. Uzbekistan's foreign exchange reserve position, including gold, is also strong. The government continues to pursue a prudent debt management policy and established a 60% external debt-to-GDP ceiling. The annual borrowing limit for 2021 on state external loan agreements is \$5 billion, and on government securities is SUM5 trillion (\$469 million).<sup>27</sup>

## E. Implementation Arrangements

23. The MOF is the executing agency for the program. The implementing agencies are the CBU, MOF, SAMA, UZRSE, and UCSD. MOF will coordinate program implementation among the implementing agencies. The policy-based loan will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). The program will be implemented

<sup>26</sup> Debt Sustainability Analysis (accessible from the list of linked documents in Appendix 2).

<sup>27</sup> Government of Uzbekistan, Ministry of Finance. 2020. *State Debt of the Republic of Uzbekistan for 2020*. Tashkent.

over 48 months (June 2019–June 2023). The indicative implementation period for subprogram 1 is June 2019–September 2021, and for subprogram 2 is October 2021–June 2023.

### III. ATTACHED TECHNICAL ASSISTANCE

24. The TA will support implementation of key reform actions under the program. It is estimated to cost \$500,000, to be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF 7). The major outputs and activities of the TA include (i) developing a coherent policy on a universal pension; (ii) developing legislation related to off-balance sheet pension fund and other government provided pensions; (iii) determining approaches to implement defined contribution and employer sponsored pension plans for the government, its agencies, and state owned-enterprises; (iv) formulating a coherent policy for development of the insurance industry in line with international standards; (v) drafting regulations and rules for the insurance industry; and (vi) facilitating the enhancement of market infrastructure to cater to new linkages, sectors, and products. The alignment of the pension and insurance regulations with those of banking and securities will be ensured to promote capital market development. The TA will be administered by ADB. MOF will be the executing agency and implementing agency. The TA will be implemented over 2 years, starting in October 2021. ADB will engage consultants through a consulting firm in accordance with the ADB Procurement Policy (2017, as amended from time to time). Disbursements under the TA will be made in accordance with ADB's *Technical Assistance Disbursement Handbook* (2020, as amended from time to time). The government will provide counterpart support in the form of counterpart staff, office space, office supplies, secretarial assistance, and other in-kind contributions.

### IV. DUE DILIGENCE

25. **Economic and financial.** The program will facilitate mobilization of financial resources for productive investment and employment generation by supporting the development of competitive financial markets. The program will help ensure balanced development of the finance sector, which will reduce systemic vulnerabilities in the bank-dominated financial system. By promoting development of the corporate securities market and institutional investors (such as insurance companies and pension funds), the program will diversify the financial instruments available and broaden the investor base. This will reduce market volatility and improve the resilience of the finance sector to external shocks. By strengthening governance of the capital markets, the program will enhance market efficiency and improve investor protection. Uzbekistan's rankings from the Transparency International Corruption Perception Index and the World Justice Project Rule of Law Index have improved, and the country's Doing Business ranking reached 69th (out of 190 countries) in 2020, from 76th in 2018.<sup>28</sup> The World Bank Doing Business 2020 report highlights that Uzbekistan earned a spot among the world's top 20 most-improved economies for ease of doing business because of key reforms that included strengthening minority investor protection by increasing the rights of shareholders and their role in major corporate decisions, clarifying ownership structures, and requiring greater corporate transparency.

26. **Governance.** ADB staff conducted a governance risk assessment in line with the Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan.<sup>29</sup> The assessment identified risks that could affect the programmatic approach, including (i) prolonged

<sup>28</sup> Transparency International. 2020. *CPI 2019: Eastern Europe and Central Asia*. Brussels (23 January); World Justice Project. 2020. [Rule of Law Index 2020](#). Washington, DC; World Bank. Doing Business: [Ease of Doing Business Rankings](#).

<sup>29</sup> ADB. 2008. *Guidelines for Implementing ADB's Second Governance and Anticorruption Action Plan (GACAP II)*. Manila.

(health and economic) measures needed to combat COVID-19, and the larger-than-projected economic downturn, which may affect program implementation and lead to changes (albeit temporary) in government reform priorities; (ii) waning government commitment and support for reform measures envisaged under the program; and (iii) weak capacity in key institutions and lack of coordination between executing and implementing agencies that could prevent proper implementation of policy actions proposed for the two subprograms. The Uzbekistan CPS (footnote 2) indicates public financial management (PFM) is deemed reliable in budget credibility, debt management, and treasury functions, but weaknesses exist when it comes to transparency, public participation, off-budget funding, internal audit, and external audit. The insufficient capacity of public institutions is another significant risk. The Public Expenditure and Financial Accountability report identifies similar risks and calls a number of actions (some of which are already incorporated in the government's PFM reform strategy): multi-year budget programming, implementation of a risk analysis and audit approach, provision of performance information on service delivery, capture and publication of all assets bought with public funds, issuance of more detailed budget execution reports, and increased financial independence of the Chamber of Accounts and scrutiny by Parliament of budget proposals and executions.<sup>30</sup> The government's PFM reforms aim to improve tax administration, introduce a medium-term budget framework, establish international public sector accounting and audit standards, and strengthen external audit. The government is committed to reforms and in 2017 launched an anticorruption campaign that includes legislative, regulatory, and institutional initiatives.<sup>31</sup> While no major risks of mismanagement of resources at the implementation level could be discerned, areas relating to institutional capacity have been targeted for capacity development under the TA and reforms under the program.

27. **Poverty and social.** Financial market reforms under the program will play an important role in raising funds cost-effectively and in enabling investors to gain access to alternative investment opportunities, while mitigating the negative impact that financial market instability has on the poor. Diversification away from a predominantly bank-based system of financial intermediation expands alternative sources of credit, thereby helping to limit systemic impacts of economic shocks. Financial markets can stimulate healthy competition with the banking sector that lowers financing costs for all borrowers. The program therefore emphasizes specific financial market reforms to help Uzbekistan diversify its financial system so that the country can realize its broad-based economic growth and socioeconomic development objectives, including poverty reduction. The program is categorized *some gender elements*. The program seeks to address gender disparities, namely women's limited access to financial markets—only 36% of women in Uzbekistan have access to financial inclusion services, out of the total female population of more than 50%.<sup>32</sup> The program promotes approval of key gender policy actions at SAMA, UZRSE, and MOF that will improve women's representation in SOEs in both managerial and working staff levels, guarantee women's equal access to training, and institute a consistent rewards and remuneration package between women and men. The MOF will also issue a policy on pensions that includes an approach to addressing any gender disparities within the pensions regime.

28. **Safeguards.** Reforms under the program do not anticipate any direct or indirect environmental impacts, will not cause involuntary resettlement, and will have no impacts on indigenous peoples. The program is classified category C for environment, involuntary resettlement, and indigenous peoples.

<sup>30</sup> World Bank. 2019. *Uzbekistan – Public Financial Management Performance Report*. Report Number 138491. Washington, DC.

<sup>31</sup> Uzbekistan's percentile rank in government effectiveness improved from 18 in 2012 to 33 in 2017, and control of corruption improved from 5 to 12. World Bank. 2018. *Worldwide Governance Indicators*. Washington, DC.

<sup>32</sup> World Bank. 2018. *The Global Findex Database 2018*. Washington, DC (accessed 10 June 2021).



29. **Risks and mitigating measures.** Major risks that could affect program implementation and mitigation measures are summarized in Table 2 and described in detail in the risk assessment and risk management plan.<sup>33</sup>

**Table 2: Summary of Risks and Mitigating Measures**

<b>Risks</b>	<b>Mitigation Measures</b>
Prolonged COVID-19 and larger-than-anticipated downturn of the economy may affect program implementation.	Continuous engagement by ADB with the government for regular consultations and monitoring. ADB will ensure COVID-19 aid effectiveness.
Vested interest groups undermine effective reform implementation.	Continuous engagement by ADB with the government. Adoption of the government's capital market development strategy (2021–2023) ensures government ownership of and commitment to reform measures under the ADB program.
Weak capacity in institutions and limited coordination between the executing and implementing agencies prevent the proper implementation of the policy actions proposed for the subprogram.	Regular policy dialogue and capacity development through technical assistance to improve capacity of the implementing agencies. The capital market development strategy institutionalizes coordination among agencies.

ADB = Asian Development Bank, COVID-19 = coronavirus disease.

Source: Asian Development Bank.

30. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

## **V. ASSURANCES**

31. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement.

## **VI. RECOMMENDATION**

32. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the programmatic approach for the Financial Markets Development Program, and
- (ii) the loan of \$100,000,000 to the Republic of Uzbekistan for subprogram 1 of the Financial Markets Development Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 2% per year during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa  
President

16 September 2021

<sup>33</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## POLICY DESIGN AND MONITORING FRAMEWORK

<b>Country's Overarching Development Objective</b> Well-functioning financial system that supports basic capital and investment needs and the country's long-term economic objectives <sup>a</sup>		
<b>Outcome</b> Capacity and size of financial markets augmented	<b>Risks and Critical Assumptions</b> R: Vested interest groups undermine effective reform implementation. R: Deterioration in investment demand because of prolonged COVID-19 pandemic crisis.	
<b>Prior Actions: Subprogram 1</b> <b>Completed: June 2019–September 2021</b>	<b>Indicative Policy Actions: Subprogram 2</b> <b>October 2021–June 2023</b>	<b>Outcome Indicators</b>
<b>Reform Area 1: Market Facilitation</b>		
1.1 The Office of the President approved a Presidential Decree on Capital Market Development Strategy guiding the direction and implementation of financial market development reforms. (CBU, MOF, SAMA)  1.2 (a) MOF and CBU agreed in a roadmap the timeline as well as terms and conditions for the (i) reorganization of UCSD; and (ii) consolidating accounting of all capital market assets, including shares, government and corporate bonds, equities, and other financial instruments in the UCSD to streamline efficient market infrastructure. (MOF, CBU)  (b) MOF and CBU agreed on a roadmap for the integration of the two trading platforms to streamline efficient market infrastructure. (MOF, CBU)	2.1 MOF to prepare and endorse to the Parliament a draft Capital Markets Law to consolidate fragmented capital markets related laws and regulations. (MOF, CBU)  2.2 CBU and MOF to supervise commencement of new functions of trading and central depository entities to streamline efficient market infrastructure. (MOF, CBU)  2.3 (a) CBU to provide Uzbekistan Central Securities Depository (UCSD) access to the Real-time Gross Settlement (RTGS) system at the CBU thereby making CBU the settlement bank for corporate securities to streamline efficient post-trading market infrastructure. (CBU, MOF, UCSD)  (b) UCSD to implement delivery versus payment for settling trades and processing corporate transactions at the UCSD to streamline efficient post-trading market infrastructure. (MOF, UCSD)  2.4 UZRSE to implement market surveillance system to prevent manipulative and illegal trading practices in the financial markets for ensuring market integrity. (UZRSE)	<b>By December 2023:</b>  Individual stock-market investor accounts increased to at least 300,000. (2019 baseline: 200,000) Source: UZRSE Annual Report  Corporate bond issuance as a percentage of GDP increased to at least 2%. (2019 baseline: 1%) Source: UZRSE Annual Report  Number of listed companies in the equity market increased to 200. (2019 baseline: 112 listed companies) Source: UZRSE Annual Report

Prior Actions: Subprogram 1 Completed: June 2019–September 2021	Indicative Policy Actions: Subprogram 2 October 2021–June 2023	Outcome Indicators
<p>1.3 SAMA implemented a policy on appointment of (i) at least one female director on the supervisory board of at least 10 publicly listed SOEs, effective after the expiry of the current supervisory board terms; and (ii) approved an action plan to adopt gender policy in these SOEs with a target to bring number of female directors at the supervisory boards to 30% by 2023 to promote gender equality in the senior management positions of publicly listed state-owned enterprises and to reinforce the requirement of the Law #LRU-562 “On guarantees of equal rights and opportunities for women and men” dated 2 September 2019. (SAMA)</p> <p>1.4 UZRSE approved a gender policy that includes elements such as minimum female representation in management, equal remuneration, and training to promote gender equality. (UZRSE)</p>	<p>2.5 SAMA will implement a policy on appointment of (i) at least one female director on the supervisory board of all other public listed SOEs by 2022, and (ii) integration of gender equality principles into the Corporate Governance Rules for SOEs. (SAMA)</p>	
<b>Reform Area 2: Demand Measures</b>		
<p>1.5 The Office of the President approved (i) a Presidential Resolution for the introduction of a digital economy and e-government, as well as (ii) a Presidential Decree on approval of the “Digital Uzbekistan – 2030” Strategy that includes amendments to the AML/CFT Law for onboarding new retail investors through implementation of e-KYC mechanisms to enhance retail investor demand. (CBU, General Prosecutor’s Office)</p>	<p>2.6 CBU and MOF to issue Fintech application regulations to allow retail investors to access the capital market through application program interfaces (APIs) for all types of capital market assets to enhance retail investor demand. (CBU, MOF)</p>	<p><b>By December 2023:</b></p> <p>Individual stock-market investor accounts increased to at least 300,000. (2019 baseline: 200,000) Source: UZRSE Annual Report</p> <p>Corporate bond issuance as a percentage of GDP increased to at least 2%. (2019 baseline: 1%) Source: UZRSE Annual Report</p>

Prior Actions: Subprogram 1 Completed: June 2019–September 2021	Indicative Policy Actions: Subprogram 2 October 2021–June 2023	Outcome Indicators
<p>1.6 MOF prepared and endorsed a draft Public Debt Law to the Cabinet of Ministers that will provide an effective public debt management framework to facilitate government bond market development. (MOF)</p> <p>1.7 The Debt Management Office (DMO) empowered by MOF approved and operationalized: (i) a restructured organizational chart for DMO (with at least three women in technical positions), and (ii) DMO's participation in sequencing and structuring MOF's Annual Borrowing Plan. (MOF)</p> <p>1.8 MOF adopted tax codes that include removal of the cascading effect (multi-level taxation of same dividend income) of taxation of dividends and a reduction in withholding tax rate on dividends distributed to resident legal entities and resident individuals from 10% to 5% to enhance investor demand. (MOF)</p>	<p>2.7 (a) MOF and CBU to publish an auction calendar for 12 months for FY2021 to help primary market participants effectively bid at auctions and facilitate government bond market development. (MOF, CBU)</p> <p>(b) MOF to implement strategy to consolidate yield curve by continuing to issue 3 and 5-year bonds and re-open stocks and consolidate to reduce fragmented issuance. (MOF)</p> <p>2.8 MOF will continue DMO empowerment through the following measures: (i) MOF to fully staff DMO with professionals with related experience according to the approved organizational chart and staffing plan; (ii) DMO to implement integrated, debt recording and information system for all government debt, providing debt composition and risk indicators. (MOF)</p> <p>2.9 (a) MOF to issue a policy on pensions that includes (i) actuarial analysis of off-balance sheet pension fund and proposed universal pension with the objective of finding a contribution rate, which represents value for money and moving some of current payments to the universal pension; (ii) an approach to creation of an autonomous and</p>	

Prior Actions: Subprogram 1 Completed: June 2019–September 2021	Indicative Policy Actions: Subprogram 2 October 2021–June 2023	Outcome Indicators
<p>1.9 IMDA prepared and endorsed a draft Law on insurance activity in the new edition to the Parliament that establishes legal framework for the development of insurance market, introduces effective regulatory mechanisms and prudential supervision as well as supports the development of investment activities of insurance (reinsurance) companies. (IMDA)</p>	<p>operationally independent national pension plan organization; (iii) a review of legislation related to off-balance sheet pension fund and other government provided pensions and revise legislation; (iv) determining modalities of implementing employer sponsored pension plans for the government, its agencies and SOEs; (v) a robust process for cross-regulatory cooperation; and (vi) an approach to addressing any gender disparities within the pensions regime. (MOF)</p> <p>(b) MOF to (i) establish a pension fund development and regulation agency; and (ii) issue and publish investment rules for private schemes. (MOF)</p> <p>2.10 (a) MOF/IMDA to issue a policy on the insurance industry that covers (i) analysis of divesting governments' ownership in state insurance companies, (ii) upgrading regulations (including paid-up capital) to comply with Insurance Core Principles developed by International Association of Insurance Supervisors (IAIS), (iii) broadening investment mandates, and (iv) a robust process for cross-regulatory cooperation. (MOF, IMDA)</p> <p>(b) IMDA to issue and publish regulations and rules (including paid-up capital) for the insurance industry to strengthen regulation and supervision of the insurance sector. (MOF, IMDA)</p>	

Prior Actions: Subprogram 1 Completed: June 2019–September 2021	Indicative Policy Actions: Subprogram 2 October 2021–June 2023	Outcome Indicators
<b>Reform Area 3: Supply Measures</b>		
<p>1.10 CBU introduced the following instruments: (i) standing facilities (overnight currency swap, overnight repurchase agreements), and (ii) auction-based operations including currency swap auctions (up to 2 weeks tenor), repurchase agreement auctions (up to 2 weeks tenor) and deposit auctions (up to 2 weeks tenor) to ensure well-functioning money markets that forms the basis for enhanced liquidity, pricing, and tenor extension of financial market instruments. (CBU)</p> <p>1.11 UZRSE issued revised equity and corporate bond market listing and de-listing rules to increase the number of listings that will broaden the financial markets. (UZRSE)</p>	<p>2.11 (a) MOF to issue and publish regulations for issuance of mutual funds, REITs, and ETFs to enhance the supply of alternative financial instruments. (MOF)</p> <p>(b) SAMA to complete IPO/SPO of at least three SOEs on the UZRSE to broaden and deepen the financial markets. (SAMA)</p>	<p><b>By December 2023:</b></p> <p>Number of listed companies in the equity market increased to 200. (2019 baseline: 112 listed companies) Source: UZRSE Annual Report</p>
<p><b>Budget Support</b></p> <p>ADB: Subprogram 1: \$100 million (concessional ordinary capital resources loan) Subprogram 2: \$100 million (concessional ordinary capital resources loan) Technical Assistance Special Fund (TASF 7): \$500,000 (technical assistance grant)</p>		

AML = Anti Money Laundering, APIs = application program interfaces, CBU = Central Bank of Uzbekistan, CFT = Combating the Financing of Terrorism, DMO = Debt Management Office, ETF = Exchange Traded Fund, IAIS = International Association of Insurance Supervisors, IMDA = Insurance Market Development Agency, IPO = Initial Public Offering, KYC = Know Your Customer, MOF = Ministry of Finance, MOJ = Ministry of Justice, MOU = Memorandum of Understanding, REIT = Real Estate

Investment Trust, RTGS = Real-time Gross Settlement, SAMA = State Asset Management Agency, SOEs = State Owned Entities, SPO = Secondary Public Offering, UCDS = Uzbekistan Central Securities Depository, UZRCE = Uzbekistan Republican Currency Exchange, UZRSE = Uzbekistan Republican Stock Exchange.

<sup>a</sup> Government of Uzbekistan. 2019. *Roadmap of Reforms of Uzbekistan, 2019–2021*. Tashkent.

**Contribution to Strategy 2030 Operational Priorities:** Operational priority indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=53161-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Finance
3. Contribution to Strategy 2030 Operational Priorities
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter<sup>1</sup>
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items
10. Attached Technical Assistance Report
11. Management Approved Concept Paper: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1: Republic of Uzbekistan: Financial Markets Development Program

**Supplementary Documents**

12. Program Economic Assessment
13. Debt Sustainability Analysis
14. Safeguards Assessment Matrix

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<sup>1</sup> The International Monetary Fund confirmed on 5 May 2021 that the attached IMF Executive Board Assessment in its most recent Article IV consultation (April 2021) may serve as the International Monetary Fund Assessment Letter.



## DEVELOPMENT POLICY LETTER

O'ZBEKISTON RESPUBLIKASI

VAZIRLAR MAHKAMASI



CABINET OF MINISTERS

REPUBLIC OF UZBEKISTAN

« 5 » august 20 21 y.

№ 02/1-289

100008, Toshkent shahri, Hukumat uyi  
Government House, Tashkent, 100008

To: Mr. Masatsugu Asakawa  
President  
The Asian Development Bank

## DEVELOPMENT POLICY LETTER

Dear President Asakawa,

I would like to express appreciation to Asian Development Bank (ADB) for its strong and continued support for recent reforms in Uzbekistan. Since 2017, under the strategy of Actions 2017-2021, the Government of Uzbekistan (GOU) has been undertaking comprehensive reforms in five priority areas namely (i) improvements in the system of state and public administration; (ii) ensuring the rule of law and reform of the judicial system; (iii) development and liberation of the economy; (iv) development of the social areas; and (v) ensuring security, religious tolerance, inter-ethnic harmony and constructive foreign policy.

Furthermore, to achieve diversification from state-dominated economy and inclusive and market driven growth with adequate employment opportunities GOU has prioritized reforms for (i) strengthening macroeconomic and fiscal management; (ii) improving the efficiency of the energy sector; (iii) enhancing financial sector development; (iv) creating enabling environment for the financial sector including access to finance, technology, skills and economic infrastructure; (v) restructuring of state owned enterprises (SOE); and (vi) improving social protection.

We consequently realize that a much faster rate of economic growth is needed to raise living standards in Uzbekistan and to reduce poverty on a sustained basis. It is for these reasons that the Government places a high priority to the reform of the country's financial sector.

## Reform Program and Development Finance

Our reform initiatives started with the adoption of a Strategy on Actions for Further Development of Uzbekistan (2017-2021) and follow-on Roadmap of Reforms (2019-2021). Each of these recognizes the central role played by banking and financial markets in fostering this transition. The Roadmap of Reforms in particular, tasks the Government with modernizing and developing financial markets to better address the needs of the real economy. The introduction of market-based instruments through creation of a sound enabling environment for competitive financial markets will mobilize private sector financing and sustain high rates of economic growth as the state's economic contribution is gradually reduced.

Under the Financial Market Development Program, ADB helped GOU identify the reform areas and implement them under a programmatic approach over the two subprograms. Various reforms, by their nature, have a long-term implementation period. These reforms will need to be carried out during 2-3 years. A sequel of assistance to such reforms would consolidate and stabilize achievement of improvement of financial market development in Uzbekistan. Particularly, ADB's support will be utilized to implement key reforms in the following areas:

(i) **Market facilitation.** Reforms in this area will support more efficient mobilization and allocation of resources in the economy by defragmenting and streamlining efficient and robust market infrastructure, as well as strengthened capital market legal framework. A roadmap for integration of trading platforms and reorganization of UCSD including consolidation of all capital market assets (shares, government and corporate bonds, equities, and other financial instruments) is in subprogram 1. Gender mainstreaming policies for SAMA and UZRSE are part of subprogram 1 where SAMA ensures at least one female director on the supervisory board of at least 10 publicly listed SOEs, and UZRSE approves a gender policy that includes minimum female representation in management and equal remuneration across the organization. Subprogram 1 actions include formulation of a long-term financial market development strategy will ensure that the proposed program is an integral part of a government-owned long-term development strategy. The subprogram 2 actions include submission to parliament of a Capital Markets Law to consolidate fragmented capital markets related laws and regulations, and installation of electronic market surveillance system at the UZRSE.

(ii) **Demand measures.** Demand measures in subprogram 1 include (i) submission to Cabinet of Ministers of Public Debt Law that will provide an effective public debt management framework to facilitate government bond market development; (ii) on-boarding new retail investors through simplified KYC with biometric verification; (iii) DMO staffing plan approval to strengthen debt management proficiency; and (iv) reduction in the dividend tax rate to enhance investor demand. Demand measures in subprogram 2 will (i) operationalize the DMO staffing plan; (ii) enhance institutional investor demand through establishment of a pension fund development and regulation agency to regulate and promote pension fund demand in the financial markets as well as issuance of rules and regulations (paid-up capital and asset investment) in the insurance sector; (iii) issue auction calendar as well as implement re-opening of fragmented issues and replacing them with liquid benchmarks issues to create liquidity in the government bond market.

(iii) **Supply measures.** This will involve supply measures in subprogram 1 to (i) introduce appropriate money market instruments (repurchase agreements, currency swaps) to ensure well-functioning money markets that form the basis for enhanced liquidity, pricing, and tenor extension of financial market instruments.; and (ii) issue revised equity and corporate bond market listing and de-listing rules to increase the number of listings that will broaden the financial markets. Supply measures in subprogram 2 (i) will have at least 3 initial public offerings completed for state-owned enterprises on the UZRSE that will broaden and deepen the capital markets; and (ii) promote introduction of alternative asset classes (exchange-traded funds, real estate investment trusts).

The proposed program, as presented, is the right approach to ensure sustainability of government reform efforts. At the same time, the government is fully aware of the challenges standing ahead. Many proposed reforms will require acquiring new skills by certain officials. We, therefore, request comprehensive long-term support from ADB for capacity development and training. Without such support, it will be difficult for us to sustain the dynamics of reforms.

Let me reassure that we remain committed to the implementation of the reforms. We also confirm that the policy actions proposed under this program are reflective and fully in consonance with the reform agenda of GOU.

We would like to thank ADB for working closely with GOU in developing this program and would like to reiterate our full support for it. We hope to continue our cooperation with ADB to initiate other reforms to provide a favorable legal and institutional infrastructure for improved financial market development, leading to higher growth and employment opportunities.

Yours sincerely,



Jamshid Kuchkarov  
Deputy Prime Minister  
of the Republic of Uzbekistan