

PROFILE

Uzbekistan: Promoting Savings and Credit Unions Through Legal Reform

By World Council of Credit Unions, Inc. (WOCCU)

Project Summary

In Uzbekistan, the implementation of a legal and regulatory enabling environment helped speed the development of financially sustainable credit unions.

The Need for Change

While under the Soviet Union's control, cooperatives in Uzbekistan were established as direct arms of the state, subject to central planning. These cooperatives were primarily agricultural and did not function as member-controlled institutions.

In Uzbekistan, as in other former Soviet countries, the banking system was owned and operated by the state, so there was no legal framework permitting the establishment of credit unions or other non-bank savings and credit institutions. Banks largely focused their efforts on larger commercial and industrial investments, excluding the majority of the population from accessing credit.

Today, the banking sector in Uzbekistan is largely privatized, but continues to be dominated by large banks that do not cater to the needs of the majority of the population. In most rural areas, there are no institutions that accept small deposit amounts or give small loans. The large banks continue to focus on large-scale commercial lending, and are not interested in taking the business or financial risks associated with maintaining branch offices in rural areas. The lack of institutions available to consumers has contributed to a low savings rate in Uzbekistan; Uzbekistan's domestic savings is approximately five percent of the gross domestic product, one of the lowest rates in the world.

Although the first credit unions in Uzbekistan were established in 1992, for ten years they lacked a legislative and regulatory framework. Perhaps as a result, 150 credit unions are in violation of accepted management standards and are at risk of failure.

In neighboring countries, development projects have focused efforts on developing micro-level savings and credit organizations without reforming the existing legal and regulatory framework. Although these efforts have shown that savings and repayment rates in communities can be high and have demonstrable developmental impacts, the projects have been limited to a small scale and lack an institutional mechanism to ensure financial sustainability over time.

Reform Process

A project by the World Council of Credit Unions, Inc. (WOCCU) and U.S. Agency for





International Development, was initiated to work with the Uzbekistan government to establish a legal and regulatory framework to support the growth and sustainability

of the credit union sector. Under the project design, activities to develop new credit unions in Uzbekistan were planned only after the regulatory environment had been created.

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officials of the Central Bank in dialogue and training sessions. The activities determined the lack of any legal basis for registration and supervision to be the single largest factor precluding the sustainable development of savings and credit unions.

Following the needs assessment stage, the project began working with the government on regulatory design and capacity building. The project produced a number of regulatory and guidance documents, including:

- Draft legislation and by-laws for credit unions;

- Regulations/prudential operating standards for the Central Bank to use in licensing and supervising credit unions;
- Examination procedures and forms for supervising savings and credit unions; and
- Organizational and operational procedures for credit unions.

The policy blueprint also called for the creation of a Savings and Credit Union Development Organization, an apex organization of participating credit unions to represent the credit unions in partnerships with government and provide technical training, services, and management assistance to its members.

Outcome

In May 2002, a credit union law and regulation implementing the project's policy framework was enacted. By the end of 2002, seven new credit unions had been formed. Uzbekistan now has 20 registered credit unions that provide financial services to over 33,000 members and manage approximately \$6,000,000 (U.S.) in member savings and total outstanding loans. Approximately two-thirds of the outstanding loans are for agriculture or micro-enterprise purposes. Savings growth rates are increasing by more than 50 percent a month in the country.

WOCCU is monitoring credit union financial ratios with PEARLS Financial Performance Monitoring System, which is similar to the standards used by United States financial institutions to assess safety and soundness. The project is now working to develop the Savings and Credit Union Development Organization to provide financial and technical support, including a deposit insurance fund to the credit union sector.

Lessons Learned

The project's experience in Uzbekistan displayed the value of focusing credit union development efforts on the legal and regulatory environment. Prior to the establishment of a proper legal and regulatory enabling environment, many credit unions entering the market did not operate with sufficient safety and soundness measures to ensure the protection of savings deposits with a productive earning asset structure. Once a proper regulatory environment had been established in Uzbekistan, the development of financially sustainable credit unions proceeded at a swift pace.

Based on the experiences in Uzbekistan, WOCCU has endorsed the following general principles of legal and enabling environment reform:

- Credit unions should be treated as regulated businesses;
- Government should lead the development effort by creating an enforcement/regulatory agency that is internally supported by the credit unions and the Central Bank (this creates a system similar to the United States National Credit Union Agency, which is independent of the credit unions and the government); and
- An incentive system should be built into the regulatory agency in order to enforce regulations and implement sanctions, overseen by an independent authority or agency. ■

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