

**Report on the Legal and Regulatory Environment
for Microfinance Activities in the Republic of Tajikistan**

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List of Abbreviated Terms

ADB – Asian Development Bank
ADB MOU – ADB Memorandum of Understanding
AKDN – Aga Khan Development Network
CGAP – Consultative Group to Assist the Poorest
CLP – USAID Commercial Law Project (USAID Legal Infrastructure for a Market Economy ARD/Checchi)
EBRD – European Bank for Reconstruction and Development
FX – Foreign exchange
IFC – International Finance Corporation
IFI – International financial institution
JSC – Joint stock company
LLC – Limited liability company
LoB – Law on Banks and Banking Activities
MCI/NABW – Mercy Corps International/National Association of Business Women
MCI – Mercy Corps International
MFC – Microfinance Centre for Central and Eastern Europe and the Newly Independent States
MFI – Microfinance institution
MoF – Ministry of Finance
MoJ – Ministry of Justice
MSDSP – Mountain Societies Development Support Program
NABW – National Association of Business Women
NBFI – Non-bank financial institution
NBT – National Bank of Tajikistan
NGO – Nongovernmental organization
OSI/Soros Foundation – Open Society Institute (Soros Foundation)
ROSCA – Rotating savings and credit association
SMEs – Small and medium-sized enterprises
UNDP – United Nations Development Program
USAID – United States Agency for International Development
VAT – Value Added Tax

Preliminary Note

The authors of this Report, Kate Lauer, Timothy R. Lyman and David Sargsian, are lawyers who are members of the bars of New York, Connecticut and Armenia, respectively. None is a member of the Tajik bar. However, they have worked on this project with the following lawyers at the USAID Commercial Law Project (CLP) in Dushanbe: Robert Underwood, Akbar Muratov, Sukhrob Khojimatov and Jamshed Murtazokulov. CLP reviewed the text of this Report in final draft form and confirmed all statements made therein about Tajik law and regulation and its current interpretation.

Notwithstanding the foregoing, this Report is not intended to constitute legal advice. To the best of the authors' knowledge, the contents of this Report are current as of July 26, 2002.

The authors would like to thank the lawyers at CLP for their invaluable assistance. The authors would also like to thank the Consultative Group to Assist the Poorest (CGAP), Open Society Institute (OSI/Soros Foundation) and the Asian Development Bank (ADB) for having provided the following materials which were indispensable to the completion of this Report: (i) the CGAP Microfinance Sector Assessment report (drafted by CGAP consultant Delbert A. Fitchett and OSI/Soros Foundation consultant Graham Owen), which provided key figures and information on the microfinance operations currently underway in Tajikistan as well as planned legal and regulatory reform efforts and (ii) two ADB documents: the ADB Memorandum of Understanding with the Republic of Tajikistan and the Summary of Proceedings of the ADB-sponsored Conference on the Legal and Regulatory Environment for Microfinance held in Dushanbe on May 6-7, 2002. This collaboration is a tribute to the donors working in Tajikistan and their efforts to cooperate and coordinate their significant funding and support for development of microfinance in Tajikistan, particularly in the area of legal and regulatory policy and reform. These cooperation and coordination efforts stem from a donor microfinance seminar held on February 7, 2002 organized by CGAP (with financial support from USAID).

Finally, the authors would like to acknowledge and thank all the persons consulted in the preparation of this Report, especially the public officials interviewed. These persons are listed in Appendix B.

I. Introduction

This Report outlines the legal and regulatory environment for microfinance activities in the Republic of Tajikistan (referred to herein as 'Tajikistan') and makes recommendations, in light of the policy reform work currently underway, regarding the steps to be taken to ensure the healthy and stable development of the microfinance sector. The Report was commissioned by the Microfinance Centre for Central and Eastern Europe and the Newly Independent States (MFC), with financial support from the United States Agency for International Development (USAID).

The material in the Report is based on (i) a review of Russian and/or English translations of relevant legislation of the Republic of Tajikistan as well as various secondary materials (all of which are listed in Appendix A), (ii) legal advice and assistance from the USAID-funded Commercial Law Project (CLP) in Dushanbe, (iii) interviews with officials from the President's Office (including its Legal Department), the National Bank of Tajikistan (NBT), the Ministry of Finance (MOF) (including its Legal Department), the Ministry of Justice (MOJ), the Tax Committee and the Agency for Anti-Monopoly Policy, Consumer Protection and State Support of Entrepreneurs as well as donors and microfinance practitioners (all of whose names are listed in Appendix B) and (iv) the documents referred to in the Preliminary Note hereto as well as minutes of various meetings and conferences (as listed in Appendix A).

Part II of this Report outlines the current situation of the microfinance sector in Tajikistan, focusing on legal and regulatory issues, and summarizes recommendations for legal and regulatory reform. Parts III, IV, V and VI of the Report outline in detail the current provisions of Tajik law and regulation affecting organizations that might carry out microfinance activities, focusing on: forms of legal entity that might be used to provide microfinance services (Part III); financial sector laws and regulations and their application to organizations carrying out microfinance activities (Part IV); legal and regulatory treatment of lending activities and collateral (Part V); and taxation as applied to microfinance activities and organizations carrying out such activities (Part VI). Part VII of this Report sets forth the authors' recommendations.

II. Situation Analysis and Summary of Recommendations

A. The Microfinance Sector in Tajikistan¹

There are between 15 to 20 microfinance operations in Tajikistan today, the majority of which engage only in cash lending.² [CGAP report, p. 13, para. 21; p. 15,

¹ Much of the material in this Section is based on a June 2002 draft Microfinance Sector Assessment Tajikistan report prepared for CGAP by Delbert A. Fitchett (CGAP Consultant) and Graham Owen (OSI/Soros Foundation Consultant) (CGAP Report).

² A few MFIs have established limited 'savings' operations (e.g., ACTED's 'credit and savings unions' which are formed out of 4-10 groups, each averaging 25 members [CGAP report, p. 46, para. 24] and ACTED's ROSCAs, which are formed of groups of 12 people with subgroups of six [CGAP report, p. 47, para. 25]), 'compulsory savings' (e.g., Sitorai Najot) or informal insurance schemes (e.g., NABW). [CGAP report, pp. 37, 42, 46-47] As of December 2001, ACTED had assisted in the formation of 249 ROSCAs (a

para. 23] However, only nine MFIs³ operate a portfolio of any significant size with the three largest responsible for 95% of total disbursements in 2001. [CGAP report, p. 13]. Most of the MFIs are international NGOs and operate under the protection of a bilateral agreement. There are a few local NGOs; however, most are affiliated with, and conduct their operations through, international NGOs. The smaller operations include five UN-supported projects that conduct microlending operations as a component of their humanitarian projects. [CGAP report, p. 17]

While there are currently 14 banks and two loan societies operating in Tajikistan [ADB MOU dated May 2002, para. 8; CGAP report, p. 9],⁴ none directly engages in microlending [Interview with Lewis Tatem, May 30, 2002] . However, at least one MFI, Mercy Corps International/National Association of Business Women (MCI/NABW), uses the banking sector for some aspects of its operations (e.g., collecting repayments). [CGAP report, p. 9] Additionally, Aga Khan Development Network (AKDN) plans in the coming year to establish a bank that will take over the microloan portfolios of AKDN's Tajik affiliates and perform various banking activities, including deposit taking. [CGAP report, p. 5 ; AKDN report; Interview with Altaaf Hasham, May 29, 2002]

The total portfolio of microloans currently outstanding is less than US\$3 million. [CGAP report, p. 5] The total number of clients in Tajikistan being served by MFIs is estimated at 44,000, with the top three MFIs accounting for approximately 36,000 of those people; the other MFIs run very small operations with the number of borrowers ranging from 42 (this does not include the size of the ROSCAs and other groups formed by ACTED, as described in footnote 2) to approximately 3,000. It is estimated that only a fraction of the microclient market is being served (the ADB estimates that 150,000 rural households do not have access to credit and almost all rural households (700,000) have no access to deposit services [ADB MOU, p. 3, para. 14; CGAP report, p. 24]); however, several additional microlending operations are scheduled to commence operations this year. [CGAP, p. 4]

While it is expected that donors will invest US\$15 million in microfinance in Tajikistan over the next three to five years [CGAP report, p. 24], basic institutional development generally remains an urgent issue throughout the sector. Many of the currently operating MFIs began with humanitarian activities; only recently has the sector begun to focus on developing sustainable practices. [CGAP report, p. 12, para. 19; p. 15, para. 26] According to the CGAP report, "The majority of the [microlending NGOs] do not fully understand or accept the difference between doing microcredit as part of a humanitarian exercise and setting up viable and financially sustainable MFIs that can be

rotating savings and credit association is an informal arrangement based on simple working rules) with a total membership of over 2,700 people. The members' savings averaged US\$24.

³ The term "MFI" is used in this Report to refer to an institution (for profit or nonprofit) as well as a program (operating within an organization) that provides financial services to lower income individuals and microenterprises that lack access to financial services from the mainstream financial sector (referred to collectively in this Report as "microclients"). Where the distinction is critical, the term "microlending" is used to indicate that the program or institution is engaged in lending only.

⁴ In 1998, there were 27 banks; the number has fallen due to liquidations following increases in minimum capital requirements, bankruptcies and consolidations. [CGAP report, pp. 10-11]

part of the country's financial framework." [pp. 15-16, para. 26] The report notes that "the majority of microcredit NGOs are using Excel to track their loans, which is inadequate for future growth." [p. 18, para. 29] In addition, "few microcredit NGOs have operations manuals or reporting systems that follow CGAP standards." [p. 18, para. 30] The CGAP report advises that "substantial training and technical assistance focused on institution-building is needed by almost all microcredit NGOs in Tajikistan, focused on developing staff manuals, lending procedures, business plans, accounting systems, loan tracking systems, and other institutional systems and procedures." [p. 18, para. 31]

Because most of the NGOs engaged in microfinance presently work either through or in partnership with an international NGO or multilateral institution, and therefore enjoy protection under various bilateral agreements, the microfinance sector has thus far been shielded from the application of many Tajik laws and regulations. Most of these NGOs are concerned about consequences of the change in their status after this protection terminates. [CGAP, p. 22] Their concern is obviously shared by locally formed organizations that already operate outside the protection of bilateral agreements.

B. Current Legal Environment in Tajikistan⁵

During the past ten years, in an effort to support the development of a market-oriented economy, Tajikistan has amended much of its existing legislation and has passed new legislation. (Appendix A sets forth the dates of various amendments and of new laws reviewed in connection with this Report.) Additional new legislation includes laws on LLCs, on accounting, on competition and others. There are certain inconsistencies between the newly enacted laws and the previously existing laws and some harmonizing is needed. This is particularly important with respect to conflicts between the Civil Code and the Law on JSCs, the Law on Pledge, the Law on Bankruptcy and the Law on State Registration of Enterprises, all of which need amending and clarification.⁶

Some of these recent changes and desired future changes do not impact directly on the ability of organizations to offer microfinance services. Other changes, however -- in particular, changes to the banking legislation, provisions of the Civil Code, the Law on Public Associations, the Law on State Registration of Enterprises, the Law on Pledge and the Tax Code (as discussed in more detail in the Section VII) -- would create a more predictable and favorable operating environment for organizations engaged in microfinance activities. Current laws and regulations with direct relevance for microfinance activities are discussed in detail in Parts III, IV, V and VI of this Report.

C. Summary Recommendations

Significant progress has been made in identifying critical legal and regulatory issues affecting the development of microfinance in Tajikistan and achieving consensus among donors, practitioners and policymakers regarding priorities for microfinance-

⁵ This Section is largely based on a draft report (dated April 22, 2002) entitled "The Current Status of Market-Oriented Legislation in Tajikistan" prepared for the CLP by Peter B. Maggs (Maggs report).

⁶ Generally speaking, the Civil Code is superior to all other legislation, and in the event of a conflict between the Civil Code and other laws, the Civil Code is applied.

related legal and regulatory reform.⁷ However, despite the significant obstacles, there are a variety of legal vehicles that can be used to carryout microfinance activities in Tajikistan under present law. These include public associations, foundations, joint stock companies, limited liability companies, loan societies and banks. Each of these potential vehicles for microfinance activities manifests specific shortcomings that warrant consideration in further planning of microfinance-related legal and regulatory reform.

In the case of non-depository MFIs (commercial and non-commercial), existing laws need to be amended to remove any ambiguity regarding the ability of such organizations to engage in microlending without an NBT license. In the case of existing NBT-licensed NBFIs, clarification is needed regarding the rules applicable to the one existing type of NBFIs (the loan society). In addition, changes are required to establish a more sensible regulatory framework for all NBFIs. Specialized regulation (or legislation) is needed to establish an appropriate regulatory framework for credit unions and similar cooperative depository financial institutions. To provide a practical and convenient regulatory vehicle for a specialized depository 'microfinance banks' (and to facilitate the capacity of banks generally to provide microfinance services), various changes to the prudential regime applicable to commercial banks warrant consideration. Finally, the general operating environment will be improved by a variety of cross-cutting reforms, such as clarification of registration requirements for legal entities (particularly those engaged in financial service delivery), clarification and improvement in the tax treatment of microfinance and improvements in collateral law.

There is less consensus on the best *technical approach* to accomplish these changes. The ADB's proposal, as reflected in the ADB MOU with the NBT, would involve the adoption of a new 'Law on Microfinance Services' that would exist alongside the existing financial sector laws and regulations and would establish a new form of specialized depository MFI. As discussed in Section VII (Recommendations), this approach, while legally feasible, carries with it both disadvantages and advantages that warrant careful consideration.

III. Legal Forms

A. Introduction

While there are various commercial and non-commercial legal forms that might be used to carry out microfinance activities, including licensed financial institutions, some of the laws and regulations governing these forms (and the interplay of such laws and regulations) are not altogether clear. The basic legal attributes of each currently available legal form are outlined below (with a focus on aspects specifically relevant to their usefulness as vehicles for microfinance), followed by a short list of the critical shortcomings of each legal form (from the microfinance perspective).

⁷ Current legal and regulatory reform initiatives affecting microfinance are set forth in Appendix C.

B. Non-Commercial Legal Forms

1. General

There are two Tajik nonprofit legal forms that could be used to conduct microfinance activities: public associations⁸ and foundations.⁹ While the legal form of public association is in fact the form used by most (if not all) of the existing NGO MFIs (including foreign NGOs), it is not an ideal legal form for engaging in microlending and related activities.¹⁰ The legal form of foundation, which became available only with the adoption of the new Tajik Civil Code in 1999, seems to offer a more appropriate option for structuring NGO MFIs.

As is the case with most other legal forms (other than NBT-licensed financial institutions, which are registered with the NBT (see Section III.E.1)), both public associations and foundations (as well as branches of foreign NGOs) must be registered in a public registry of legal entities maintained by the Ministry of Justice.¹¹ [Civil Code, Art. 51.1] However, the 1991 Law on State Registration of Enterprises, which should be amended to establish a unified state registry and registration procedure (as required by the Civil Code), has not been amended since adoption of the Civil Code. In the absence of such a unified registry and established procedures, public associations and foreign NGOs follow the registration requirements set forth in the 1998 Law on Public Associations [Law on PA Arts. 14, 32.4] (the passage of which preceded the adoption of the Civil Code) and foundations have only the general registration provisions in the Civil Code.

Upon registration, their legal existence commences. The Civil Code specifically permits non-commercial organizations such as public associations and foundations to engage in "entrepreneurial activities" (defined as profit-making activity undertaken at the actor's risk [Civil Code, Art. 1.3]), but only to the extent that the activities serve the purpose for which the organization was founded. [Civil Code, Art. 50(3)] With the exception of the basic features that both the public association and foundation possess, most of their other attributes differ and are discussed separately below.

⁸ Although this Report uses the term "public association," there are other terms for this type of legal form, including "societal and religious organizations (or amalgamations)" (the terminology used in the English translation of the Civil Code, Art. 129).

⁹ The other available NGO legal forms – unions and institutions – are not suitable. A union is formed to coordinate the activity of its members and to represent and protect the members' common interests. [Civil Code, Art. 133] An institution does not provide the owner with any limitation on liability. [Civil Code, Art. 132]

¹⁰ This is also the view of Deputy Minister of Justice, Mrs. Tojinisso Azizova. [meeting on May 24, 2002]

¹¹ Note that the Law on Public Associations, which was adopted before the Civil Code, provides that a public association with strictly local or regional activities is registered with the Department of Justice of the relevant *khukumat* (or territorial administration body). [Law on PA, Art. 14] This appears to contradict the Civil Code, which specifies a unified registry.

2. Public associations

Governing Law. Public associations are governed by two basic pieces of legislation, the Law on Public Associations and the Civil Code.¹² As noted in footnote 11, the Law on Public Associations conflicts with certain provisions of the Civil Code; under Tajik law, on each point of conflict, the provisions of the Civil Law prevail.

Establishment and Founders. A public association is a voluntary association of individuals (whether Tajik or foreign). [Civil Code, Art. 129, Law on PA, Art. 12.2] There must be at least three founders. [Law on PA, Art. 1]

Permitted Purposes and Activities. A public association is a non-commercial organization formed for the purpose of satisfying spiritual or other non-material needs of its members. [Civil Code, Art. 129] As noted above, the Civil Code permits a public association to conduct entrepreneurial activity, but only in connection with achieving the purposes for which it was created. The Law on Public Associations includes among the permissible purposes of a public association the "execution and protection of civil, political, *economic*, social and cultural rights and freedoms of the citizens." [Art. 6] (Emphasis supplied.) In addition, the Law on Public Associations specifically provides that an association's rights include "engaging in production-economic activities in accordance with the requirements of Tajik legislation." [Art. 20] These provisions appear to provide a legal basis for forming a public association for the primary purpose of carrying out socially targeted microlending. However, a conservative interpretation might conclude that the narrower list of allowable purposes mentioned in the Civil Code conflicts with the list in the Law on Public Associations, in which case a public association engaged primarily in microlending would have to argue that its activities satisfy non-material needs *of its members*.

In addition, as discussed in Section V.A.4, the boundary line between lending (permitted by any individual or legal entity) and crediting (permitted only by NBT-licensed financial institutions) is unclear.

Access to Capital. According to the Law on Public Associations, a public association may raise funds through entrance and membership fees, voluntary donations and contributions. [Art. 24] In addition, a public association may borrow funds.¹³ [Civil Code, Art. 826.1] The property transferred to a public association by its members is the property of the association. [Civil Code, Art. 129.2] A public association may not distribute its income to members. [Law on PA, Art. 24.4]

In the event of the voluntary liquidation (and certain involuntary liquidation) of a public association, the property remaining after satisfaction of creditors' claims shall be used in accordance with the purposes indicated in the association's charter or as decided during a general meeting of the association. [Law on PA, Art. 19, part 2]

¹² Foreign NGOs, which are not mentioned in the Civil Code, are governed by the Law on Public Associations. [Law on PA, Art. 32, part 4]

¹³ The law is not clear, however, regarding borrowing and onlending. See the discussion in Section V.A.2 below.

Management. The management structure is to be determined by the charter of the association. [Law on PA, Arts. 13.2 and 13.5]

Governmental Oversight; Reporting. The public prosecutor and the MoJ are generally responsible for overseeing operations of public associations. [Law on PA, Art 26, part 1]. This includes primarily the legal power to monitor a public association's compliance with its purposes (as set forth in its charter). The MoJ may (i) demand that management of a public association submit its adopted decisions, (ii) receive from the public association explanations connected with the compliance with its charter and (iii) designate MoJ representatives to participate in events organized by the public association. [Art. 26, part 3, Public Association Law] Fiscal authorities also have the power to monitor the activities of public associations with regard to taxation. [Art. 26, part 2, Public Association Law] Written warnings may be issued if a public association fails to comply with its charter or relevant legislation [Law on PA, Art. 28, parts 1 and 3] and, if the public association fails to comply with a warning, a court may suspend a public association's activities [Law on PA, Art. 29, part 1] or even liquidate the association [Law on PA, Art. 29, part 3]. In the event of involuntarily liquidation due to a public association undertaking prohibited activities (e.g., engaging in propaganda of racial, national, social, religious hate, war or pursuing the forceful change of the constitutional system and organization of military groups) [Law on PA, Art. 6, part 2], a public association's property may be forfeited to the state. [Law on PA, Art. 30, part 3].

Legal Feasibility of Transformation. There are no provisions of law or regulation specifically governing transformation of a public association into another type of legal entity.

Shortcomings. As with other organizational legal forms that operate without an NBT license, public associations face (i) the ambiguity of the dividing line between loans under the Civil Code and credits, which require an NBT license and (ii) lack of clarity regarding the legal right to borrow and onlend the borrowed funds.

There are two shortcomings of the particular legal form of public association. First, arguable ambiguity surrounds the question whether a public association can be formed for the primary purpose of engaging in social-purpose lending. Second, legal entities may not be members.

3. Foundations

Governing Law. Foundations are governed by provisions of the Civil Code. There is no separate legislation on Tajik foundations.

Establishment and Founders. A foundation is founded by individuals and legal entities (whether Tajik or foreign) on the basis of voluntary contributions of property. A foundation is not a member-based organization. Property contributed to the foundation by its founders is the property of the foundation. [Civil Code, Art. 130.1]

Permitted Purposes and Activities. A foundation is formed to pursue social, charitable and other socially useful purposes. [Civil Code, Art. 130.1] A foundation is to use its property for the purposes set forth in its charter. [Civil Code, Art. 130.2] There appear to be no legal barriers to forming a foundation for the primary purpose of engaging in socially targeted microlending. However, as discussed in Section V.A.4, the boundary line between lending (permitted by any individual or legal entity) and crediting (permitted only by NBT-licensed financial institutions) is unclear.

As noted in Section III.B.1, a foundation may engage in entrepreneurial activities if necessary for the socially useful purposes for which it was created. [Civil Code, Art. 130.2] A foundation may also form a commercial organization or be a participant in a separate commercial organization in order to pursue entrepreneurial activities. [Civil Code, Art. 130.2]

Access to Capital. A foundation may raise funds through contributions of its members, voluntary donations and contributions and borrowings.¹⁴ [Civil Code, Arts. 130.1, 606, 826.1] The property transferred to the foundation by its founders is the property of the foundation. [Art. 130.1]

In the event of the liquidation of a foundation, the property remaining after satisfaction of creditors' claims shall be used in accordance with the purposes indicated in the charter of the foundation. [Civil Code, Art. 131.3]

Management. The management of a foundation is determined by its charter. [Civil Code, Art. 130.3]

Governmental Oversight; Reporting. A foundation is required to publish reports on the use of its property annually. [Civil Code, Art. 130.2] No other form of governmental oversight is specifically provided for with respect to foundations. The mechanism pursuant to which the public prosecutor and the MoJ would oversee the activities of a foundation (as with public associations) is not specified.

Legal Feasibility of Transformation. There are no provisions of law or regulation specifically governing transformation of a foundation into another type of legal entity.

Shortcomings. As with other organizational legal forms that operate without an NBT license, foundations face (i) the ambiguity of the dividing line between loans under the Civil Code and credits, which require an NBT license and (ii) lack of clarity regarding the legal right to borrow and onlend the borrowed funds.

The Civil Code provisions governing foundations, although broadly permissive, are scant, leaving many questions of interpretation open to speculation. Elaboration of the provisions would be beneficial, either through amendment of the Civil Code or the adoption of a Law on Foundations.

¹⁴ The law is not clear regarding borrowing and onlending. See the discussion in Section V.A.2 below.

C. Commercial Companies

1. General

Among the existing Tajik commercial legal forms, two provide potentially workable vehicles for microfinance: joint stock companies (JSCs) and limited liability companies (LLCs).¹⁵ [Law on JSCs, Art. 1] Like other forms of legal entity (other than NBT-licensed financial institutions, which are registered with the NBT (see Section III.E.1)), JSCs and LLCs must register in a public registry of legal entities maintained by the Ministry of Justice and their legal existence commences upon registration.¹⁶ [Civil Code, Art. 51.1] As stated in Section III.B.1, the 1991 Law on State Registration of Enterprises, which should be amended to establish a unified state registry and registration procedure (as required by the Civil Code), has not been amended since adoption of the Civil Code. In the absence of such a unified registry and established procedures, JSCs follow the registration requirements set forth in the Law on JSCs. [Art. 6] As part of the procedure, within 10 days after the company's registration, it must notify the MoF in order to be included on the MoF-published State Registration list of all registered and liquidated companies. [Law on JSCs, Art. 6] (There is no such requirement for LLCs.)

2. Joint Stock Companies

Governing Law. JSCs are governed by the Civil Code and by the Law on JSCs.

Shareholders. A JSC is an organization owned by shareholders, who may be individuals or legal entities, foreign or Tajik.¹⁷ [Law on JSCs, Art. 3] A JSC may be formed as an open or a closed company. [Law on JSCs, Art. 2] There is no restriction on the number of founders of an open JSC [Law on JSCs, Art. 3]; however, the number of shareholders in a closed JSC may not exceed 50. [Law on JSCs, Art. 2] Shareholders of an open JSC have the right to sell their shares without the consent of the other shareholders; shareholders of a closed JSC may only sell their shares with the consent of the other shareholders. [Law on JSCs, Art. 2] If the number of shareholders of a closed JSC exceeds 50, then it must hold a meeting of shareholders to change to an open JSC. [Law on JSCs, Art. 2]

¹⁵ Other legal forms include general partnerships, limited partnerships and companies with supplemental liability, none of which constitute convenient vehicles for microfinance. The participants in a company with supplemental liability jointly and severally bear subsidiary liability for the company's obligations in accordance with a multiple of the value of their contributions. In the case of bankruptcy of one of the company's participants, its liability is distributed among the remaining participants. [Civil Code, Art. 105]

¹⁶ Current law does not contain any provisions on registering branches of foreign companies nor on the treatment of foreign companies under Tajik Law. However, the Law on Foreign Investment does require that state registration of enterprises *with foreign investment* is to be effected by the State Notary Office following a determination of the Ministry of Finance regarding the foreign investment. [Art. 14]

¹⁷ While the legal procedures for foreign investment in Tajikistan (whether by individuals or legal entities) must be similar to the procedures applicable to Tajik individuals and legal entities, there may be additional taxes or privileges for foreign investment in certain sectors of the economy. In addition, foreign investors may be prohibited or limited in their ability to invest in certain enterprises (e.g., there is a maximum foreign ownership interest with respect to Tajik banks). [Law on Foreign Investment, Art. 6]

The authorized capital of an open JSC must be at least 100 times the minimum monthly wage applicable at the time of registration. The authorized capital of a closed JSC must be at least 60 times the minimum monthly wage applicable at the time of registration. [Law on JSCs, Art. 7] At least 30% of the share value of the company must be paid-in prior to registration (and not later than 30 days after the founding meeting). [Law on JSCs, Art. 6] With the agreement of all of the initial shareholders, initial contributions may be made in non-monetary form. The value of the property is determined with the cooperation of all of the participants. [Law on JSCs, Art. 7]

Each common share has one vote. A JSC may also issue non-voting preferred shares; however, the percentage of capital comprised of preferred shares may not exceed 25%. [Law on JSCs, Art. 10; Civil Code, Art. 113.1]

Permitted Purposes and Activities. A JSC may engage in any economic activity listed in its charter and not prohibited by law.¹⁸ [Law on JSCs, Art. 1] However, as discussed in Section V.A.4, the boundary line between lending (permitted by any individual or legal entity) and crediting (permitted only by NBT-licensed financial institutions) is unclear.

Access to Capital. Companies may raise capital through capital contributions and general borrowings.¹⁹ However, for borrowings of more than one year, a JSC may only borrow through the issuance of bonds. [Law on JSCs, Art. 13]

A JSC must establish a cash reserve of no less than 15% of its authorized capital. [Law on JSCs, Art. 18] Deductions for the reserve fund are determined by the shareholders, but may not be less than 5% of the net annual profit for every year until the 15% minimum is achieved. [Law on JSCs, Art. 18]

Management. A JSC with more than 50 shareholders is managed by (i) its board of directors, which is responsible for general management (other than those matters in the exclusive purview of the shareholders) and (ii) an executive body (either a directorate or a general director), which is responsible for the day-to-day operations of the company. [Civil Code, Art. 114.2, 114.3] Representatives of the executive body may not comprise a majority in the board. Management may not serve as members of the board of directors. [Law on JSCs, Art. 22]

The shareholders also elect an audit committee. [Law on JSCs, Art. 24] Members of the committee may not be members of the board of directors or an executive officer. The committee undertakes inspections at the instruction of the general meeting of shareholders, at its own initiative or at the request of the owners of at least 10% of the voting shares of the company. [Law on JSCs, Art. 24]

Reporting. A JSC must produce its annual report and balance sheet within a month after its annual meeting. The annual report must be inspected by an audit firm

¹⁸ Depending on the type of activity in question, a JSC may need to obtain a license or licenses prior to commencing business. An example is banking activities, discussed in Section III.E below.

¹⁹ The law is not clear regarding borrowing and onlending. See the discussion in Section V.A.2 below.

appointed by the shareholders. [Law on JSCs, Art. 20] The company must issue and distribute a quarterly balance sheet, a profit and loss statement and any other current information to its shareholders. [Law on JSCs, Art. 20] The annual report, balance sheet and statement of profit and loss must be published annually. [Civil Code, Art. 114.5]

Legal Feasibility of Transformation. A JSC may transform into an LLC or a production cooperative.²⁰ [Civil Code, Art. 115.2] An existing, operating JSC may not transform into a bank.²¹

Shortcomings. As with other organizational legal forms that operate without an NBT license, JSCs face (i) the ambiguity of the dividing line between loans under the Civil Code and credits, which require an NBT license and (ii) lack of clarity regarding the legal right to borrow and onlend the borrowed funds.

Pursuant to the Law on Foreign Investment, JSCs have to register their foreign capital with the Ministry of Finance.

3. Limited Liability Companies

Governing Law. Although the Civil Code includes provisions on LLCs, there is also a newly passed Law on LLCs. However, the authors were informed that it has not yet been translated into either Russian or English. The following general description of the legal attributes of LLCs below is therefore based solely on the relevant provisions of the Civil Code.

Owners. An LLC may be established by one or more persons (both individuals and legal entities); however, an LLC may not be established by a company with only one owner. [Civil Code, Art. 94] At least 50% of the charter capital must be paid in before registration.²² [Civil Code, Art. 97.3]

The number of participants in an LLC may not exceed 30. If the number does exceed 30, then the company will be required to transform into a JSC within one year (or be liquidated if the number of its participants is not reduced to the maximum permitted number). [Civil Code, Art. 95.1] The risk of loss of a participant in an LLC is limited to the equity invested in the company by the participant. [Civil Code, Art. 94.1]

A participant in an LLC may transfer its interest to another participant. [Civil Code, Art. 100.1] The transfer or sale to a non-participant is permitted unless the charter provides otherwise. [Civil Code, Art. 100.2] A participant has the right of first refusal with respect to interests being sold by another participant in the company. If a participant wishes to sell its interest (or part of it) and no other participant is interested (and sale to a non-participant is forbidden by the company charter), the company must purchase such interest. [Civil Code, Arts. 100.2, 100.3]

²⁰ Currently, however, there is no specific law on production cooperatives. See III.D infra.

²¹ Documents required to apply for a banking license must be submitted to the NBT within one month of the signing of the JSC founding agreement. [Instr. 100, Art. 17]

²² The balance must be paid in during the first year of operations. [Civil Code, Art. 97.3]

Permitted Purposes and Activities. A JSC may engage in any economic activity listed in its charter and not prohibited by law.²³ [Law on LLCs, Art. 5] As discussed in Section V.A.4, the boundary line between lending (permitted by any individual or legal entity) and crediting (permitted only by NBT-licensed financial institutions) is unclear.

Access to Capital. An LLC may raise capital through capital contributions (which may be made in monetary or non-monetary form) and general borrowings.²⁴

Management. An LLC is managed by an executive body – either a group or one individual – elected by the participants. [Civil Code, Art. 98.1] In addition, an executive director may also be elected, provided that the executive director may not be an owner of the company. [Civil Code, Art. 98.1]

Reporting. The Civil Code provides that an LLC is not required to publish its annual report and balance sheet. [Civil Code, Art. 98(5)] However, any participant in an LLC may demand an outside audit. [Civil Code, Art. 98(5)] The information filed with the State Registrar must be kept up-to-date.

Legal Feasibility of Transformation. An LLC may transform into a JSC or a production cooperative.²⁵ [Civil Code, Art. 99.2]

Shortcomings. As with other organizational legal forms that operate without an NBT license, LLCs face (i) the ambiguity of the dividing line between loans under the Civil Code and credits, which require an NBT license and (ii) lack of clarity regarding the legal right to borrow and onlend the borrowed funds.

The shortcomings applicable in particular to the LLC legal form are difficult to assess without having had a chance to review the new LLC law (which currently is not available in English or Russian). However, as with JSCs, pursuant to the Law on Foreign Investment, LLCs have to register their foreign capital with the Ministry of Finance.

D. Credit Unions and Similar Member-Owned and Governed Legal Forms

There is currently no law or normative act which appropriately governs the creation and operation of credit unions or other similar forms of member-owned and governed depository financial institutions.²⁶ Credit unions *could* qualify as an NBT-regulated credit institution, and the authors were informed by NBT officials that there is a project underway to draft the necessary normative acts to define this category of

²³ Depending on the type of activity in question, an LLC may need to obtain a license or licenses prior to commencing business. An example is banking activities, discussed in Section III.E below.

²⁴ The law is not clear regarding borrowing and onlending. See the discussion in Section V.A.2 below.

²⁵ Currently, however, there is no specific law on production cooperatives. See III.D *infra*.

²⁶ The NBT normative act governing loan societies, NBT Reg. 83 (discussed in Section III.E.2), has been erroneously identified as a regulatory vehicle for the creation of credit unions. However, the loan society lacks the essential 'one-member/one-vote' governance attribute, which is the most important defining characteristic of a credit union.

institution.²⁷ [Interview with Shamsullo Davlyatov and Akmaljon Ashurov, May 28, 2002] The authors were also informed by representatives of the President's Office that a Law on Production Cooperatives, with chapters on financial cooperatives and non-banking cooperatives, is now pending adoption in the Upper Chamber of the Parliament. [Interview with Sabohat Mukumova and Jumakhon Davlyatov, May 29, 2002].²⁸ However, neither a draft of proposed normative acts nor a draft of the pending Law on Production Cooperatives was available for review.

E. Banks and other Credit Institutions

1. General

The NBT has the exclusive right to license, supervise and regulate the activities of banks and credit institutions. [Law on NBT, Art. 31] (The terminology can at times become confusing. The term "credit institution" is not defined, although it is clear that it includes banks. The Law on Banks and Banking Activities (LoB or Law on Banks) uses the term "credit institution" only once, when defining the activities of a banking association. Otherwise, it refers to the activities of banks and *non-bank financial institutions*.) The Law on Banks clarifies that it is the responsibility of the NBT to license, register and regulate banks and NBFIs, which are defined in the Law on Banks as "legal entities that are not banks and [that] can conduct various banking operations on the basis of a license of the National Bank of Tajikistan."²⁹ (LoB, Art. 44.2) [LoB, Arts. 16.2, 44.2; see also NBT Reg. 118, Arts. 1, 13, 14 and NBT Reg. 83, Art. 8]

In 1999, the NBT established by normative act (Regulation 83) a type of NBTI: the "loan society."³⁰ (See Section III.E.3 below.) In April 2000, the NBT adopted a normative act (Instruction 100), which is the basic document governing the registration and licensing of banks and NBFIs. In January 2002, the NBT approved a "framework" normative act (Reg. 118) for all NBFIs other than "credit unions."³¹ However, the future of Reg. 118 is unclear as it has not yet been registered by the MoJ – the final step necessary for legal effectiveness. Moreover, the ADB reports that Reg. 118 is "under revision at the NBT." (ADB MOU, para. 24.)³²

²⁷ It is possible that the NBT officials were referring to the currently discussed possibility of revising NBT Reg. 83. See Section III.E.3 for a discussion of Reg. 83.

²⁸ There are general provisions in the Civil Code defining production cooperatives and consumer cooperatives. The provisions on production cooperatives state that the members' subsidiary liability for the obligations of the cooperative are to be defined by the specific statute (to be enacted) and by the charter of the cooperative. [Civil Code, 118.2] The provisions on consumer cooperatives provide that members are obligated to cover the losses of the cooperative with supplementary contributions; in the event of their failure to do so, the cooperative is to be liquidated. [Civil Code, Art. 128.4] Thus, neither appears to be an appropriate legal vehicle for microfinance.

²⁹ The Civil Code provides for a unified registry with the MoJ; thus, the provisions in the Law on Banks placing registration authority with the NBT conflict with the Civil Code. Although the Civil Code is superior to the Law on Banks, currently the registration provisions of the Law on Banks are followed.

³⁰ The Russian version translates into English as the "loan partnership."

³¹ The English translation of Reg. 118 explicitly excludes "credit unions" which are, according to the regulation, non-commercial. [Reg. 118, Art. 1]

³² If the MoJ approves and registers Reg. 118, then Instr. 100 will apply unless there is a contradiction between it and Reg. 118, in which case Reg. 118 will apply. [E-mail from Akbar Muratov, June 27]

Assuming that Reg. 118 were to be registered by the MoJ, its relationship to Reg. 83 will be ambiguous. It is unclear whether the loan societies described in Reg. 83 are *intended* to be credit unions, which are explicitly excluded from the NBFIs framework created by Reg. 118. (The loan society shares some features in common with credit unions and several commentators, including an NBT official, have referred to loan societies as "credit unions." [Dilshod Kholmatov's comments; Betty Wilkinson's written comments on Reg. 83]) If this is the intent (which it appears to be, as the authors were informed that the NBT is currently in the process of redrafting Reg. 83 to establish the legal form of credit union [Betty W. e-mail, June 13, 2002]),³³ then it explains the apparent contradiction between (a) the requirement under Reg. 118 that NBFIs not engage in deposit-taking and (b) Reg. 83 loan societies, for which deposit-taking is an essential feature. If it is not the intent, then Reg. 118 needs to be amended to permit (as the Law on Banks does) NBFIs to take deposits. In addition, certain changes to Reg. 83 will be required.

Because of the uncertainty surrounding the status and intended reach of Reg. 118, its provisions are discussed only briefly below. The discussion of loan societies in Section III.E.3 should be read with the understanding that requirements described in Reg. 118 may also be (or become) relevant to loan societies.

2. Reg. 118 Non-Bank Financial Institutions

Governing Law. As noted above, if Reg. 118 is approved and registered by the MoJ, the governing law for Reg. 118 NBFIs will be the Law on Banks and NBT Reg. 118 as well as other relevant NBT normative acts (e.g., Instructions 79 and 100). In addition, to the extent applicable, Reg. 118 NBFIs are governed by the Civil Code and either the Law on JSCs or the Law on LLCs (depending on the legal form of the institution in question).

Ownership. A Reg. 118 NBFI may be either a joint stock company or an LLC, subject to the ownership and other requirements applicable to JSCs and LLCs described in Section III.C above. [Reg 118, Arts. 5, 6, 13]. However, in no event may a legal entity that is 50% or more owned by the state be an owner of a Reg. 118 NBFI. [Reg. 118, Art. 6] If established as an LLC, there may be not fewer than two and no more than 30 owners. [Reg. 118, Art. 6]

The owners of a Reg. 118 NBFI must notify the NBT if any individual, legal entity or group acquires 5% of shares of the NBFI. [Reg. 118, Art. 27] Prior NBT approval is required for any acquisition resulting in more than 20% of the outstanding shares. [Reg. 118, Art. 28] The NBT may refuse an application if, in its opinion, (i) the financial resources of the buyer(s) are not sufficient, (ii) the buyers do not have a source for contributing additional capital, (iii) it would result in a monopoly or (iv) the law otherwise provides.

³³ This also conforms with statements by NBT officials, who reported that there is a project underway to draft a normative act to create the legal form of credit union. [Interview with Shamsullo Davlyatov and Akmaljon Ashurov, May 28, 2002]

Pursuant to NBT Instruction 100, the following limitations apply to a Reg. 118 NBFIs or any other type of NBFIs: No shareholder or participant may hold more than 65% of its charter capital. [Instr. 100, Art. 252] The NBT must give its prior approval of the acquisition by foreign shareholders or foreign participants of more than 20% of an NBFIs's capital. [Instr. 100, Art. 141] The NBT may refuse to approve the acquisition if it would violate the maximum for the total foreign capital that may be invested in the Tajik banking system. [Instr. 100, Art. 143]³⁴

Permitted Purposes and Activities. A Reg. 118 NBFIs may engage in any of the following operations for which it has the obtained the required NBT license:

- Cash operations;
- Lending operations;
- Implementation of transaction orders;
- Trust operations;
- Safe deposit operations;
- Payment clearance transactions;
- Financing capital investments for clients;
- Forfeiting operations (i.e., paying debts of a purchaser of goods through the purchase of promissory notes without having rights against the seller of the goods);
- Leasing; and
- Factoring (i.e., acquiring rights of payment from the purchasers of goods and assuming the risk of non-payment); [NBT Reg. 118, Sec. 2]

Pursuant to the Law on Banks, no Reg. 118 NBFIs nor any other type of NBFIs may invest in commercial, insurance or industrial activities, either directly or indirectly. [LoB, Art. 44.1]

Access to Capital. Reg 118 NBFIs have access to capital through share issuances (or, if an LLC, participants' equity contributions) and general borrowings.³⁵

Management. The management of a Reg. 118 NBFIs depends generally on whether it is formed as an LLC or a JSC. (See Sections III.C.2 and 3 above.) However, the specific requirements for executives are the same as those applicable to banks. (See Section III.E.4 below.) In addition, leading staff must be citizens of Tajikistan who know the State language well. [Reg. 118, Art. 16]

³⁴ Currently, the following ratio must not exceed 50%: (i) the total foreign investment in the charter capital of Tajik banks and NBFIs plus the total of the capital of foreign bank branches divided by (ii) the total charter capital of the banks and NBFIs registered in Tajikistan (including the foreign bank and NBFIs branches). [LoB, Art. 23.1] If the ratio exceeds 50%, then the NBT will cease issuing banking licenses for banks and NBFIs with foreign capital. [LoB, Art. 23.2]

³⁵ The law is not clear regarding borrowing and onlending. See the discussion in Section V.A.2 below.

Branches. Pursuant to NBT Instruction 100, a Reg. 118 NBFI (or any other type of NBFI) may only apply to the NBT to establish a branch if, for the prior six months, the NBFI had no losses, had a stable financial record and was in compliance with the prudential requirements. To establish a branch, the total capital of the NBFI must equal at least 125% of the minimum capital requirement. [NBT Instr. 100, Art. 79]. The registration fee for establishing a branch is 0.05% of the NBFI's charter capital. [Instr. 100, Art. 83]

Accounting. Pursuant to NBT Instruction 100, a Reg. 118 NBFI (as well as any other type of NBFI) must comply with international standards for financial reports and accounting principles. [LoB, Art. 8.5]

Prudential Regulation and Supervision. Pursuant to the Law on Banks, all NBFIs are to be regulated and supervised by the NBT. NBT regulations for NBFIs generally cover the various prudential matters, including (i) the minimum capital requirement; (ii) credit exposure limits; (iii) liquidity ratio and (iv) capital adequacy ratio. [NBT Regs. 79, 94] It is unclear whether regulations on those prudential matters that are primarily or exclusively relevant to depository institutions would be applied to non-depository Reg. 118 NBFIs.

Beginning January 1, 2002, the minimum requirement for the charter capital of a NBFI is US\$100,000.³⁶ [NBT Instruction 79, Art. 1] The minimum capital requirement (i.e., including loan loss reserves and taking into account the charter capital) is US\$300,000. [NBT Instruction 79, Art. 1] For the licensing of *certain* banking transactions, a Reg. 118 NBFI must fulfill the requirements on equipping the building, working space and cashier supplies applicable to banks. [Reg. 118, para. 18, referring to NBT Reg. 1132]

Shortcomings. If Reg. 118 is registered by the MoJ in its current form (which appears doubtful), there are several shortcomings (in addition to the problem with the interplay with Reg. 83). First, Reg. 118 does not include deposit-taking in the permitted activities nor does it permit an NBFI to engage in foreign exchange transactions. Secondly, as with banks, it has a high registration fee (0.5% of charter capital). Third, the requirement that the executive officers be Tajik will likely be problematic for most MFIs that involve foreign investors or sponsors.

In addition, there are limitations on ownership: (i) no shareholder may own more than 65% of an NBFI (this may also present a problem for some potential sponsors of a microfinance bank) and (ii) there is a quota on total foreign ownership of NBFIs, which is particularly problematic because foreign capital is the most likely form of investment for microfinance. And finally, there is a 20% limit with respect to the inclusion of non-monetary property in charter capital and the prohibition on the contribution of other than tangible property. [Instr. 100, Art. 21]

³⁶ The registration fee is 0.5% of the charter capital. There are also fees (0.05%) for increases in the charter capital and for all other amendments and corrections in the charter documents. [Reg. 118, Art. 20]

3. Loan Societies

Governing Law. NBT Reg. 83 establishes the "loan society" as an NBFIs that is licensed to conduct lending and other banking transactions (including deposit-taking) to serve its participants. [Reg. 83, Art. 2] (As noted above, it is unclear the extent to which Reg. 118, if registered by the MoJ, would apply to loan societies.) The other relevant law for loan societies include the Law on Banks (as for all other NBFIs) and various other NBT normative acts (e.g., Instr. 100). In addition, to the extent applicable, loan societies are governed by the Civil Code and the Law on JSCs or the Law on LLCs.

General. Although loan societies have features similar to a typical credit union (i.e., they may take deposits and make loans only to their members), they cannot be formed with the one-member/one-vote structure most characteristic of credit unions (except if formed as an LLC, in which case the number of members may not exceed 30). [NBT Reg. 83, Arts. 3, 4]

There are two loan societies operating in Tajikistan today. [CGAP report, p. 9, para. 10] Although the loan society is a feasible vehicle for microfinance, two major limitations are that a loan society (1) may not have branches and (2) is established to serve only its participants. [Reg 83, Art. 5]

Ownership. A loan society, which may be established as either a JSC or an LLC, may be owned by individuals or legal entities (residents and non-residents). In either event, no legal entity that is more than 50%-owned by the state may be a participant/shareholder in a loan society. [Reg. 83, Art. 4] If established as an LLC, there may be not fewer than two and no more than 30 owners. [Reg. 83, Art. 4]

Pursuant to NBT Instruction 100, the following limitations apply to a loan society (as well as any other type of NBFIs): No shareholder or participant may hold more than 65% of its charter capital. [Instr. 100, Art. 252] The NBT must give its prior approval of the acquisition by foreign shareholders or foreign participants of more than 20% of an NBFIs capital. [Instr. 100, Art. 141] The NBT may refuse to approve the acquisition if it would violate the maximum for the total foreign capital that may be invested in the Tajik banking system. [Instr. 100, Art. 143]³⁷

Permitted Purposes and Activities. A loan society may engage in the following banking transactions on behalf of its participants:

- Cash operations;
- Making loans to participants;
- Implementing of transaction orders of participants;
- Trust operations for participants;

³⁷ Currently, the following ratio must not exceed 50%: (i) the total foreign investment in the charter capital of Tajik banks and NBFIs plus the total of the capital of foreign bank branches and NBFIs divided by (ii) the total charter capital of the banks and NBFIs registered in Tajikistan (including the foreign bank and NBFIs branches). [LoB, Art. 23.1] [LoB, Art. 23.1] If the ratio exceeds 50%, the NBT will cease issuing banking licenses for banks and NBFIs with foreign capital. [LoB, Art. 23.2]

- Forfeiting operations for participants;
- Leasing to participants;
- Factoring for the participants;
- Safe deposit operations for participants;
- Payment clearance transactions for participants; and
- Accepting participants' deposits.

[Reg. 83, Art. 16.]

However, a loan society may not have branches. [Reg. 83, Art. 5]

Access to Capital. A loan society has access to capital through share issuances (or, if an LLC, participants' equity contributions) and general borrowings.

Prudential Requirements. Loan societies (along with all other NBFIs) are to be regulated and supervised by the NBT. As noted in Section V.E.2 above, NBT regulations for NBFIs generally cover the various prudential matters, including (i) the minimum capital requirement; (ii) credit exposure limits; (iii) liquidity ratio and (iv) capital adequacy ratio. [NBT Regs. 79, 94]

The current minimum requirement for the charter capital of a loan society (as for all NBFIs) is US\$100,000.³⁸ [NBT Instruction 79, Art. 1] The minimum capital requirement (i.e., including loan loss reserves and taking into account the charter capital) is US\$300,000. [NBT Instruction 79, Art. 1]

In addition, there are limitations on ownership: (i) no shareholder may own more than 65% of an NBFI (this may also present a problem for some potential sponsors of a microfinance bank) and (ii) there is a quota on total foreign ownership of NBFIs, which is particularly problematic because foreign capital is the most likely form of investment for microfinance. And finally, there is a 20% limit with respect to the inclusion of non-monetary property in charter capital and the prohibition on the contribution of other than tangible property. [Instr. 100, Art. 21]

A loan society must fulfill the requirements on equipping the building, the working space and the cashier supplies in accordance with the NBT normative act 1132. [Reg. 83, para. 8.1]

Shortcomings. Aside from the need to clarify whether Reg. 118 is registered by the MoJ and whether Reg. 118 is intended to apply to Reg. 83 loan societies, the loan society is not an appropriate vehicle for microfinance because it is not permitted to have branches and, together with the \$100,000 minimum requirement for charter capital, this limitation would raise the cost of operations above the reach of most existing MFIs. In addition, the loan society is established to serve only its participants. Finally, there is a high registration fee (0.5% of charter capital) plus additional fees for additional capital.

³⁸ The registration fee is 0.5% of the charter capital. [Reg. 83, Art. 13] There are also fees (0.05%) for increases in the charter capital and for all other amendments and corrections in the charter documents.

4. Banks

Governing Law. Banks are governed by the Law on Banks (LoB or Law on Banks), the Law on the NBT and the normative acts of the NBT as well as the JSC and the Civil Code to the extent applicable.

Ownership. There are three types of banks in Tajikistan: a state bank, a non-state bank and a bank with foreign participation. A state bank is owned by the Government of Tajikistan; there are no other owners. A non-state bank is owned by resident individuals and legal entities; however, shares may be owned by the Government of Tajikistan through the Ministry of Finance. A bank with foreign participation is partially owned by non-residents (which includes legal entities that are majority-owned by non-residents and resident individuals who are managers of legal entities treated as non-residents).³⁹ [LoB, Art. 4.4]

All banks other than state banks are formed as closed JSCs (but they do not have the right to issue share warrants). [LoB, Art. 8.1] A bank may become an open JSC if it has operated without losses for at least one calendar year from the moment it received its NBT banking license and has not violated any NBT norms. [LoB, Art. 8.2; Instr. 100, Art. 58]

In general, any individual or legal entity, resident or non-resident, may be a founder or a shareholder of a Tajik bank. [LoB, Art. 14] However, no shareholder may hold more than 65% of the charter capital of a bank. [LoB, Art. 13.2; Instr. 100, Art. 252] In addition, acquisitions of shares of banks (and other agreements regarding control of banks or a group of banks) must comply with the antimonopoly rules. [LoB, Art. 37.3]

With respect to foreign shareholders, the NBT must give its prior approval to the acquisition of more than 20% of the NBT's capital. [Instr. 100, Art. 141] The NBT may refuse to approve the acquisition if it would violate the maximum for the total foreign capital that may be invested in the Tajik banking system. [LoB, Art. 23.1; Instr. 100, Art. 143]⁴⁰

Capital contributions may be made in non-monetary form (although there is no prescribed valuation procedure); however, only material assets (e.g., banking equipment, the buildings where the bank is located but excluding buildings under construction) may be contributed as capital. [Instr. 100, Art. 22] In no event may non-monetary contributions exceed 20% of the initial charter capital of the bank. [LoB, Art. 29.1; Instr.

³⁹ A foreign bank may operate in Tajikistan if has an acceptable rating by a rating agency included on an NBT list. [LoB, Art. 15.2]

⁴⁰ Currently, the following ratio must not exceed 50%: (i) the total foreign investment in the charter capital of Tajik banks and NBFIs plus the total of the capital of foreign bank branches divided by (ii) the total charter capital of the banks and NBFIs registered in Tajikistan, including the foreign bank branches. [LoB, Art. 23.1] If the ratio exceeds 50%, the NBT will cease issuing banking licenses for banks with foreign capital. [LoB, Art. 23.2]

100, Arts. 20, 23] In the event of additional increases in the charter capital, non-monetary contributions may not exceed 10% of any such increase. [Instr. 100, Art. 23]

Any individual, legal entity or group acting in concert that acquires more than 5% of the voting shares of a bank must notify the NBT of such acquisition. [LoB, Art. 13.5] Prior NBT approval is required for any acquisition resulting in ownership of more than 20% of the outstanding voting shares. [Id.] The NBT may refuse an application if, in its opinion, (i) the financial resources of the buyer(s) are not sufficient, (ii) the buyers do not have a source for contributing additional capital, (iii) it would result in a monopoly or (iv) the law otherwise provides. Any refusal must be reasonable. [Art. 13.5]

Permitted Purposes and Activities. As specified in the Law on Banks [Art. 2.2], a bank may engage in the following banking operations:

- Taking deposits (from both legal entities and individuals);
- Extending credits;
- Opening and servicing clients' accounts, correspondent accounts of banks and NBFIs and accounts of metals;
- "Accounting operations" (i.e., discounting bills of exchange and other promissory notes);
- Foreign exchange operations;⁴¹
- Issuing credit cards;
- Safekeeping of assets and securities;
- Fiduciary (trust) operations;
- Payment and money transfer operations.

If a bank wishes to engage in the following additional operations, it must first receive an additional license from the NBT: (i) the purchase, acceptance of collateral, accounting, custody and sale of precious metals, (ii) securities brokerage services, (iii) guarantee operations (issuing warrants, guarantees, stand-by letters of credit), (iv) leasing activities, (v) issuing its own securities, (vi) factoring and similar activities (i.e., buying and collecting claims) and (vii) conducting operations outside of Tajikistan. [LoB, Arts. 2.3, 2.4; Instr. 100, Arts. 125, 127]

Access to Capital; Charter Capital. Banks have access to capital through (i) share issuances, (ii) deposits, (iii) general borrowings and (iv) issuances of commercial paper.

The charter capital must be in the national currency. [LoB, Art. 13.1] The current minimum capital requirement (including loan loss reserves) for an operating bank is US\$2.0 million; this will increase to US\$2.5 million on January 1, 2003 and to US\$3.0

⁴¹ The license to operate in foreign currency is given after one year of a bank's operation if the bank has "modern means of communication and appropriate experts." (LoB, Art. 2.4) However, if the bank is owned in part by a foreigner (or if the bank is a branch of a foreign bank), it may conduct operations in foreign currency within three months after commencement of operations.

million on January 1, 2004. The minimum charter capital of a newly established bank is US\$3.0 million.⁴² [NBT Instruction 79]

Management. The management bodies of a bank are its board and its executive body. [LoB, Art. 8.4] In addition, as with all JSCs, there is an audit committee. [LoB, Art. 12.6] Members of the committee may not be members of the board of directors or one of the executive directors. The committee undertakes inspections at the instruction of the shareholders, at its own initiative or at the request of the owners of at least 10% of the voting shares of the company. [Art. 24]

Executives of a bank include the following: the chairman of the bank and his or her deputies, the chief accountant and his or her deputies, and a bank branch's chief accountant and his or her deputies. [LoB, Art. 19.1] Executives must be citizens of Tajikistan. (The head of a foreign bank branch must also be a Tajik citizen.) [Overview of Current Banking Legislation, p. 3]

The Law on Banks specifies additional requirements for each position. The chairman of the board must, among other things, have a higher economic education (or have more than ten years' experience as an official in a bank or NBF) and must not have been an executive in a company that went bankrupt or in a bank or NBF that was denied an NBT license. [LoB, Arts. 19.3, 19.4] Other executives must have higher or secondary education appropriate for the job and must fulfill certain of the requirements applicable to the chairman. [LoB, Art. 19.5] All of the executives must have appropriate experience in the banking system, as detailed in the Law on Banks. [See LoB, Art. 19.6 for details.] An NBT qualification commission is responsible for determining whether a person meets the specified requirements for his/her executive position. [LoB, Art. 19.2] The NBT must be notified of, and consent to, any changes in executive personnel. [LoB, Art. 20.7]

Branches. A bank may apply to the NBT to establish a branch only if, for the prior six months, the bank had no losses, had a stable financial record and was in compliance with the prudential requirements. The total capital of the bank must be equal to or more than 125% of the minimum capital requirement. [NBT Instr. 100, Art. 79]. The registration fee is 0.05% of the bank's charter capital. [Instr. 100, Art. 83]

A foreign bank must obtain a NBT license before establishing a branch in Tajikistan. [Instr. 100, Art. 164] A branch of a foreign bank is an independent legal entity. [Instr. 100, 156]

Accounting and Audits. All banks must comply with international standards for financial reports and accounting principles. [LoB, Art. 8.5]

Each bank is required to submit to the NBT at its request any information on the bank's funds, including funds deposited outside of Tajikistan; deposits and credits;

⁴² The minimum capital requirement for an operating bank was US\$500,000 as of January 1, 1999 and was increased by US\$500,000 annually. The minimum requirement for the charter capital of a newly-established bank was US\$1.0 million as of January 1, 1999 and was increased by US\$500,000 annually for the following three years. [NBT Instruction 79]

banking transactions and other information, including confidential information. [LoB, Art. 41.2]

Reports; Disclosure. A bank must be audited annually by an auditor licensed by the NBT. [LoB, Art. 42.1, 42.2] A copy of the auditor's report must be presented to the board and the executive body of the bank and to the NBT (together with additional information about the audit, if requested by the NBT). [LoB, Art. 42.3; 42.5]

At the end of the financial year, a bank must submit to the NBT (i) the bank's audited financial report and (ii) information on its activities and operations during the year. [LoB, Art. 43.1] Banks are also required to publish audited annual reports (including the annual balance sheet and the profit and loss statement) after approval of the annual balance sheet and the profit and loss statement by the annual meeting of shareholders. [LoB, Art. 43.2]

The representative office of a foreign bank must submit an annual and semi-annual report to NBT. [Instr. 100, Art. 200] In addition, the representative office must inform the NBT of changes in its foreign staff (i.e., the number of foreign employees, which may not exceed two persons [Instr. 100, Art. 188]) as well as extraordinary events. [Instr. 100, Art. 202]

Prudential Regulation and Supervision. All banks and foreign bank branches are regulated and supervised by the NBT. The Law on Banks specifies that the NBT is to carry out its activities by (i) establishing prudential norms and limit requirements, (ii) issuing compulsory instructions and other normative acts for banks, (iii) controlling banks' activities, (iv) issuing recommendations in improving the financial standing of banks, (v) taking other "influence measures" with respect to banks and (vi) imposing sanctions on banks. [LoB, Art. 28]

NBT regulations cover the customary prudential matters,⁴³ including (i) minimum capital requirement; (ii) maximum non-cash portion of the charter capital (which in no event shall exceed 20% of the charter capital of the bank); (iii) credit exposure limits; (iv) liquidity ratio; (v) capital adequacy ratio; (vi) foreign exchange, interest and other risks; (vii) maximums for acquiring interests in other legal entities. [LoB, 29.1]

Deposit Insurance. The Law on Banks requires banks to create a deposit insurance fund. The NBT is responsible for determining the procedure for forming the fund and its size. [Arts. 28.2, 40.2] The fund has not yet been established. However, there is a draft law prepared by the NBT that is currently under review. [CLP comment, July 22 draft]

Transformation. Reg. 118 provides that a bank may reorganize into an NBFI in accordance with relevant legislation and normative acts of the NBT. [Reg. 118, Art. 21] A bank may transform into a loan society in accordance with the NBT Regulation "On

⁴³ The NBT is entitled to establish different ratios and procedures for different types of banks and other credit institutions. [Law on NBT, Art 46]

the order of establishing commercial banks and termination of their activity on the territory of Tajikistan." [Reg. 83, Art. 14] The procedure for reorganization requires NBT approval, and the wrapping up of most of the bank's activities (including collecting all outstanding credits and loans) prior to the reorganization. [Reg. 83, Arts. 14, 15]

Shortcomings. Although the following factors are not necessarily 'shortcomings' when considered for traditional banking activities, they would be shortcomings if the commercial bank were to be used as a vehicle for conducting microfinance activities: (i) the applicable prudential requirements are significantly more burdensome than those applicable to any other microfinance vehicles discussed in this Report and (ii) the requirement that all bank executives be Tajik citizens (a requirement that also applies to NBFIs) will most likely be problematic for many potential sponsors of microfinance banks.

In addition, the following limitations on ownership may be problematic for some potential sponsors of a microfinance bank: (i) no shareholder may own more than 65% of a bank and (ii) there is a quota on total foreign ownership of banks. And finally, the 20% limit with respect to the inclusion of non-monetary property in charter capital and the prohibition on the contribution of other than tangible property [Instr. 100, Art. 21] will create problems for AKDN and any other potential sponsor of a microfinance bank that intends to fund charter capital in part with the contribution of existing loan portfolios.

IV. Financial Sector Laws and Regulations

A. Law on the National Bank of Tajikistan

The NBT is responsible for all institutions granting credits.⁴⁴ It is also responsible for licensing banks. It has plenary regulatory authority regarding financial sector matters. Specifically, the NBT has the power to do many things by normative act (as opposed to by the parliamentary procedure).

The principal objectives of the NBT, according to the law establishing it, are to achieve and maintain a stable currency; to develop and strengthen the banking system; and to assist in the efficient and effective operation of the payment system. [LoNBT, Art. 3] In order to fulfill its objectives, the NBT has various functions, including (i) to license, supervise and regulate the activities of banks and other credit institutions, [LoNBT, Art. 4(4)] (ii) to extend credits to banks and other credit institutions⁴⁵ and (iii) to supervise the payment system and facilitate interbank payments. [LoNBT, Arts. 4 and 18] The NBT is responsible for issuing normative acts and regulations binding upon all banks and credit institutions, legal entities and individuals.⁴⁶ [LoNBT, Art 5] Unless otherwise specified, all such acts and regulations become effective upon their date of

⁴⁴ See the discussion on the distinction between loans and credits in Section V.A.4, below.

⁴⁵ Except in exceptional cases, the NBT loans to banks must be secured. [LoNBT, Art. 21]

⁴⁶ Draft national laws and draft statutory acts and regulations of republican executive bodies that are relevant to the NBT's functions are to be submitted to the NBT for review. [LoNBT, Art 5]

adoption (and may in no event be retroactive) and must be mailed or otherwise communicated to all registered banks and other credit institutions. [LoNBT, Art. 5]

In connection with the its regulatory functions with respect to banks and other credit institutions, the NBT is authorized to: develop standards for supervising their activities; to conduct inspections of such institutions using NBT employees or qualified specialists; to require such institutions to provide the information necessary for supervision and regulation of their activities; to require such institutions to take measures to rectify problems; and, if necessary, to apply legal sanctions against such institutions. [LoNBT, Art 31] The NBT is entitled to publish the information and aggregate data of banks and credit institutions. [LoNBT, Art 33]

B. Law on Banks and Banking

The Law on Banks prohibits any person and any legal entity from (i) accepting deposits or executing other "banking transactions" or (ii) auditing banking activities without a license from the NBT. (LoB, Art. 5.1) This prohibition does not apply to the NBT, branches and representative offices of banks and international financial institutions (e.g., World Bank, IFC, ADB, EBRD). [LoB, Art. 5.2] In addition, the prohibition regarding accepting deposits does not apply to loans, provided that with respect to any such loan, the amount to be repaid may not exceed the initial amount.⁴⁷ [LoB, Art. 5.3] Banking transactions carried out without an NBT license are not considered valid. [LoB, Art. 5.4] Although the term "banking transactions" is not defined, it appears to mean those activities listed in Art. 2 of the Law on Banks.⁴⁸

Any legal entity that carries out banking operations without a license is liable for the total amount of proceeds involved in the relevant transactions and is subject to a fine equal to double such amount. The imposition of the fine is an "indisputable order" when made by the appropriately authorized government agency and the NBT. [Art. 17.3] In addition, the NBT may demand liquidation of any legal entity undertaking banking operations without a license. Individuals engaged in unlicensed banking operations shall be subject to liability in accordance with the law. [LoB, Art. 17.5]

V. Lending Activities and Collateral

A. Lending Activities

1. Who may Lend

Under the Civil Code, there is no restriction on who may be a lender. [Civil Code, Art. 826.1] NBT officials have confirmed that the Civil Code permits non-banks to engage in lending and that the NBT does not license, regulate or supervise

⁴⁷ Although it would not be sensible, this provision could be read to mean that a legal entity that borrows (from individuals and legal entities) and does not pay interest does not risk being viewed as taking deposits. See additional discussion in Section V.A.2 on the possible interpretation of Section 5.3 of the Law on Banks.

⁴⁸ The list set forth in Article 2 of the LoB is also set forth above in Section III.A.2.

organizations engaged in lending (as opposed to "crediting") activities. [Statement of Dilshod Kholmatov of NBT at meeting of MFI Coordination Group, April 5, 2002.] According to Mr. Kholmatov, the NBT "consider[s] it unnecessary to register and license the MFIs established on the basis of organizational and legal forms envisaged by the civil legislation and where the activity is beyond the Law on Banks and Banking Activity." [Id.] However, practitioners remain concerned about their legal power to lend, largely out of fear that their lending might be interpreted as extending credits, an activity restricted to NBT-licensed financial institutions, as discussed in Section V.A.4 below.

2. Sources of Funds for Lending

The Civil Code does not prohibit the onlending of borrowed funds, regardless of the type of legal entity involved. However, only institutions operating with an appropriate NBT license may take deposits. This raises the question of when borrowing for onlending will be considered deposit-taking. The Law on Banks lists a number of possible exceptions to the general prohibition on non-NBT licensed entities engaging in deposit-taking. One of the listed exceptions is for a loan where the repayment amount does not exceed the initial amount (effectively, an interest-free loan). [LoB Art. 5.3] However, in order to be effective, the listed exceptions must be implemented by NBT normative acts. As of today, no normative act has been adopted to effect the exception for interest-free loans. [Id.]

This provision raises the question whether, in the absence of an implementing normative act, interest-free loans *are* to be treated as deposits. Moreover, even if an implementing normative act were in place, a question would remain whether an interest-bearing loan that is used for onlending would be necessarily considered a deposit. It seems unlikely that the NBT would take the extreme position that all loans used for onlending constitute deposit-taking, as this would require a banking license in many commercial situations not typically viewed as raising prudential concerns. It would also have the effect of making it impossible for all types of MFIs (other than those few capable of being licensed by the NBT) to finance portfolio growth from any borrowing (other than interest-free loans, if an implementing normative act were adopted).

3. Loan Agreement⁴⁹

If the lender is a legal person, the loan agreement must be in writing. [Civil Code, Art. 827.1] The lender is entitled to be paid interest by the borrower. If the agreement does not set forth the rate of interest, then (except in certain cases) the rate is to be determined by the interest rate fixed at the date of repayment. [Civil Code, Art. 828.1]

If an agreement does not explicitly provide for a term for the loan, the loan must be repaid within three months after the lender demands repayment. [Civil Code, Art. 829.1]

⁴⁹ The rules on loan agreements set forth in the Civil Code also apply to credit agreements. [Civil Code, Art. 838.3]

4. "Credit" vs. "Loan"

Like other former Soviet legal systems, Tajik law recognizes a distinction between "loans," a concept elaborated in the Civil Code, and "credits," a concept developed in the Law on the National Bank and the Law on Banks and Banking Activity. Loans, under the Civil Code, involve the transfer of money or other property from a lender to a borrower and an obligation for the borrower to return the borrowed property (or, if the borrowed property is not money, then property in an equal quantity and quality as the property originally transferred by the lender) to the lender in installments or in one repayment. [Civil Code, Art. 826.1] There is no limitation on the type of legal entity that may be a lender (or a borrower) under the Civil Code, and the terms of a loan – including the interest rate, if any – are up to the parties to decide.

The Law on Banks does not define the term "credit" nor does it clarify the distinction between credits and Civil Code loans. The Civil Code defines a "credit agreement" as the provision of monetary funds by a creditor to a borrower. There is no further elaboration of the concept, except that it is stated that generally only banks and other credit organizations may extend credits. [Civil Code, Arts. 838.1, 838.2] According to Mr. Shamsullo Davlyatov, Head of Legal Department of the NBT, the only legal distinction between a credit and a loan is the institution engaged in the activity: the obligation is a credit only if an NBT-licensed financial institution is extending the funds. [Interview with Shamsullo Davlyatov and Akmaljon Ashurov, May 28, 2002]

As previously noted, NBT officials have already tried to reassure microlenders that the Civil Code provides an adequate legal basis for their activities and that their activities fall outside the NBT's sphere of interest so long as deposit-taking is not involved. Nonetheless, microlenders are likely to continue to have concerns as long as the distinction between loans and credits remains a topic for NBT's interpretive discretion, rather than one laid out clearly and unambiguously in the relevant laws and regulations.

B. Interest Rates

There are no restrictions on interest rates.

C. Collateral

In Tajikistan, permissible collateral includes the pledge of any property (movable or immovable) other than certain common exceptions. [Law on Pledge; Civil Code, Art. 359-360]. Thus, the following forms of collateral are possible [Civil Code, Art. 362]:

- mortgage, with the pledged assets remaining in the possession and use of the pledgor or third party;
- deposit, with the pledged assets transferred by the pledgor to the possession of pledgee;

- the pledge of rights that can be alienated;⁵⁰
- cash, which if pledged must be deposited with a bank or notary office.⁵¹

The Civil Code provides general framework for the development of detailed legislation governing pledges, pledge agreements and mortgages and state registration of the rights arising from mortgages and pledges of movable property. [Arts. 359-387] Of the issues that need to be addressed, the following three are the most pressing: the lack of a centralized state registry for all types of collateral, the inability to pledge intangibles (such as business receivables) and the high cost of enforcing collateral interests. Current Tajik policy is to resolve the mortgage-related issues first.⁵²

VI. Taxation

A. General

The national-level Tajik taxes most directly relevant to microfinance⁵³ include:

- Income tax on individuals (both residents and non-residents); [Part IV and V, Art. 117 – 125; Art. 130 - 175]
- VAT; [Part VI and VII, Art. 176 - 207]
- Profits tax on legal entities; [Part V, Art. 126 – 130; Art. 130 - 175]
- Excise tax; [Part VIII, Art. 208 - 221] and
- Tax on property of an enterprise. [Part XII, Art. 260 - 266]

Of these taxes, VAT and profits tax raise issues of significant concern to existing MFIs in Tajikistan.

In general, the Tajik tax system distinguishes between "economic activity" and "charitable activity." "Economic" activity is recognized as "any activity aimed at receiving profits, income or compensation, regardless of the results of such activity." [Art. 8] Charitable activity is *not* regarded as economic activity [Art. 8] and is defined as "activity carried out by an organization and consisting of providing material or other assistance (support), including money donations, to physical persons in need of assistance or to organizations that render such assistance directly ..." [Art. 11.1] Although the Tax Code specifically refers to assistance to low-income persons, it also provides that assistance is not considered charitable activity if "the person who receives the assistance

⁵⁰ If the pledge of the rights is represented by the securities, they must be transferred to the pledgee or deposited with a bank or notary office, unless otherwise provided by the pledge agreement.

⁵¹ The pledgor is entitled to any interest that accrues.

⁵² According to representatives of the World Bank working on a collateral law project, a new law is being developed that will establish a detailed mechanism for the registration and enforcement of mortgages. [Meeting on May 28, 2002 with WB PIU representatives: Zamira Tillokhodjaeva, Head and Shurullo Gayurov, Legal Specialist] It is not expected that this project will address issues relating to movable assets. However, CLP is also planning collateral law reform, and is likely to include in this work the establishment of workable systems for pledging movable assets and intangibles. [Interview with Robert Underwood, May 23, 2002]

⁵³ Local taxes that may be relevant to microfinance include tax on the property of individuals. [Art 6]

incurs an obligation" to the supplier of the assistance. [Art. 11.3] Microlending, therefore, cannot qualify as charitable activity.

"Entrepreneurial activity" is a subset of "economic activity" and consists of all economic activities except those appearing on a narrow list of specific exceptions deemed to be "non-entrepreneurial." [Art. 9] Neither microlending nor any other microfinance service fits within any of the non-entrepreneurial activities listed.

B. VAT

Individuals and legal entities carrying out "economic activity" generally must register as subjects of value added taxation (VAT) (meaning that they must, in general, charge and remit VAT).⁵⁴ [Tax Code, Art. 178] However, the rendering of financial services is exempt from VAT. This means that consumers of financial services are not generally charged VAT by their financial service providers. [Art. 187.b] However, while "credits" are specifically recognized as VAT-exempt financial services, "loans" are not (although another term for a specific type of loan *does* appear on the Russian translation of the list).⁵⁵ Officials of the Tax Committee did, however, express to the authors the opinion that the financial services VAT exemption should be interpreted to apply also to loans. [Interview with Usufjon Rakhmonkulov, Azam Bobojojev and Nuraly Saidov, May 27, 2002]

The transfer of collateral from pledgor to pledgee is considered to involve the supply of goods under the Tax Code [Art. 27.14] and is therefore generally subject to VAT. [Tax Code, Art. 182.2] However, collateral supplied in the context of *crediting* activity fits within the definition of VAT-exempt financial services. [Tax Code, Art. 27.17 and Art. 187.b] It is reasonable to assume that if the VAT exemption for financial services were extended to loans generally, this would apply also to collateral supplied in connection with loans.

C. Profits Tax and Deductions

Both resident and foreign enterprises pay profits tax in Tajikistan.⁵⁶ [Art. 126.1] Officials of the Tax Committee confirmed that any form of legal entity carrying on microfinance activities (even if only socially targeted microlending) would be construed to be an enterprise subject to profits tax on any net surplus of revenues over expenses. [Interview with Usufjon Rakhmonkulov, Azam Bobojojev and Nuraly Saidov, May 27, 2002]

⁵⁴ Individuals and legal entities whose taxable transactions in the preceding 12 months did not exceed 12,000 times the nontaxable minimum income are not obliged to register as VAT subjects. [Tax Code, Art. 178]

⁵⁵ See the discussion of the distinction between loans and credits in Section V.A.4 above.

⁵⁶ A resident enterprise has its place of establishment or place of management in Tajikistan; a foreign enterprise is an enterprise that does not qualify as a resident enterprise. [Tax Code, Art. 14] A resident enterprise is taxed on profit derived both in Tajikistan and abroad; a foreign enterprise is taxed only on income from the activities engaged in in Tajikistan. [Art. 127.2]

Income received by non-residents (e.g., dividends and interest) from Tajik sources is subject to a withholding tax in Tajikistan. [Arts 147, 148, 149] Thus, to the extent that a Tajik MFI borrows funds from abroad – whether from its parent organization or a foreign bank – the MFI will be required to pay withholding tax on interest payments on the loan. Withholdings may be reduced or eliminated under applicable double taxation treaties.

Grants, membership dues and contributions received by an organization are exempt from profits tax, as are dividends received by a resident enterprise from a resident enterprise. [Art 129]

A variety of deductions are available in calculating net profits subject to tax.⁵⁷ These include (among others): a charitable contribution deduction (up to 2% of taxable profit [Art. 133]); a deduction for interest paid on a loan or credit (up to 125% of interbank credit auction of the NBT [Art. 134]); a deduction for doubtful debts in connection with goods, work and services supplied, if the income was previously included in gross income from entrepreneurial activity [Art 135.1]; and deductions for operating expenses (many of which are limited to amounts listed in an approved schedule). [Art. 131, 138, 139, 142] An enterprise may carry forward losses for up to five years. [Art. 145]

Banks and other NBT-licensed financial institutions are eligible for deductions that are specifically relevant to providers of financial services. For example, these types of institutions may deduct 100% of moneys allocated to a reserve fund to cover doubtful and bad debts in accordance with NBT rules (although the deduction is only permitted for "substandard" loans). [Art. 135] Tax Committee officials are aware of the uneven playing field resulting from not according Civil Code lenders such as NGO MFIs the same deductions that NBT-licensed institutions may take, and are amenable to extending equal treatment with respect any deductions not specifically limited to NBT-licensed institutions in the Tax Code itself. [Interview with Usufjon Rakhmonkulov, Azam Bobojojev and Nuraly Saidov, May 27, 2002]

Tax Committee officials are also aware that net revenue from socially targeted microlending by NGOs in many other countries (particularly outside the former Soviet Union) is not subject to profits tax. [Id.] However, they read the Tajik Tax Code as unambiguous on the following point: NGO microlenders in Tajikistan *are* subject to profits tax on net revenue from their activities. Moreover, the officials point out that this situation can be altered only by legislation amending the Tax Code itself (which can only be introduced by the Government, and not by an individual parliamentarian, ministry or other governmental body).⁵⁸ [Id.]

⁵⁷ There is a special provision for enterprises owned more than 20% by a non-resident or by a legal entity with exempt status. [Art. 134.2]

⁵⁸ The authors specifically asked Mr. Usufjon Rakhmonkulov, Head of the Department of Direct Taxation, and Mr. Azam Bobojojev, Chief of the Department of Financial, Credit and Insurance Organizations and Currency Control, whether the principle of *lex specialis* could be applied to a provision of a free-standing 'Law on Microfinance Services' if it purported to provide for profits tax exemption on socially targeted NGO microlending. Mr. Rakhmonkulov and Mr. Bobojojev answered unequivocally that *lex specialis* is

VII. Recommendations

Despite noted shortcomings, the existing legal and regulatory framework in Tajikistan does offer a variety of options for conducting microfinance activities. Each of these options would benefit from clarification of a relatively modest number of ambiguities and the removal of other obstacles in order to create a clearer and better-defined operating environment for microfinance.

There is already broad consensus as to the *content* of many of the changes needed. In the case of non-depository MFIs (NGOs and microlending JSCs and LLCs), existing laws need to be amended to remove any ambiguity regarding the ability of such organizations to engage in microlending without an NBT license.⁵⁹ In the case of existing NBT-licensed NBFIs, clarification is needed regarding the rules applicable to the one existing type of NBTI (the loan society). In addition, changes are required to establish a more sensible regulatory framework for all NBFIs.⁶⁰ Specialized regulation (or legislation) is needed to establish an appropriate regulatory framework for credit unions and similar cooperative depository financial institutions. To provide a practical and convenient regulatory vehicle for specialized depository 'microfinance banks' (and to facilitate the capacity of banks generally to provide microfinance services), various changes to the prudential regime applicable to commercial banks warrant consideration.⁶¹ Finally, the general operating environment will be improved by a variety of cross-cutting reforms, such as clarification of registration requirements for legal entities (particularly those engaged in financial service delivery), clarification and improvement in the tax treatment of microfinance and improvements in collateral law.

There is less consensus on the best *technical approach* to accomplish these changes. The ADB's proposal, as reflected in the ADB MOU with the NBT, would involve the adoption of a new 'Law on Microfinance Services' that would exist alongside the existing financial sector laws and regulations and would establish a new form of specialized depository MFI. This approach, while legally feasible, carries with it both disadvantages and advantages that warrant careful consideration. Particularly significant among the disadvantages is the practical problem that virtually all the existing financial sector laws and regulations would still require amendment in order to be harmonized with the proposed 'Law on Microfinance Services.' Moreover, other laws would also need amending to cover topics not possible to address in the new law.⁶²

not permitted in the context of tax legislation, and therefore that the provision would be void unless accompanied by an appropriate amendment to the Tax Code itself.

⁵⁹ The recommendations herein do not address the operation of small, community-based, informal savings and credit arrangements, such as ROSCAs. The authors would recommend that there be an explicit and carefully circumscribed exception in the law to permit such small, informal groups to function outside of the regulatory framework.

⁶⁰ It should be noted that all NBFIs, by definition, are licensed by the NBT.

⁶¹ As noted above, the NBT is entitled to establish different ratios and procedures for different types of banks and other credit institutions by the adoption of normative acts, without the need for new legislation. [Law on the NBT, Art. 46]

⁶² Regardless whether a new 'Law on Microfinance Services' is adopted, not all of the desired changes *can legally* be effected through such law (as noted in the ADB MOU). [ADB MOU, p. 9] For example, some

The recommendations below address the following: (i) the changes needed to eliminate existing ambiguities and remove existing obstacles for the MFI types mentioned above;⁶³ (ii) the potential disadvantages and advantages of adopting of a new 'Law on Microfinance Services'; (iii) the legislative amendments that will be needed -- regardless of the technical approach taken -- to clarify the operating environment for the various types of MFIs (including key registration issues, tax issues and collateral issues); and (iv) the importance of harmonizing microfinance-related legal and regulatory reform with broader financial sector reform.

A. Clarification of Legal Status of Lending Organizations Operating without an NBT License

Legal Exemption from Requirement of NBT License. Almost all of the existing MFIs are microcredit NGOs. Although the Civil Code permits legal entities (and individuals) to make loans, microfinance practitioners are not comfortable with the lack of a clear line separating "lending" under the Civil Code from "crediting," which requires an NBT license. The MFIs have expressed a desire for an explicit acknowledgement of the legal power of non-NBT licensed organizations to engage in monetary lending. The authors recommend an amendment to the Law on Banks or the passage of an NBT normative act⁶⁴ clarifying that organizations engaged in lending activities (and *no other banking activities*) do not require a banking license. This amendment or normative act would have the additional benefit of helping to clarify the applicable registration requirements for lenders operating without an NBT license, as discussed in Section VII.F below.

The amendment or normative act would need to address whether such lending institutions would (i) be engaged in Civil Code lending or (ii) be "credit institutions" (specifically, NBFIs). The distinction has relevant ramifications for MFIs. For example, a lender treated as an NBT-regulated NBFi would clearly be VAT exempt and would be able to enjoy profits tax deductions enjoyed by other NBT-regulated institutions such as banks, without any amendment of the Tax Code. However, it would appear that categorization of such lenders as NBFIs would also make them subject to the foreign investment quotas applicable to banks and NBFIs. In addition, there are compelling practical and regulatory policy reasons not to put a permitting process for microlenders in the hands of the same regulatory agency responsible for carrying out prudential

of the tax issues must be addressed through amendments to the Tax Code, which can only be introduced in Parliament by the Government as a whole; collateral issues must be addressed through amendments to the Law on Pledge and the Civil Code.

⁶³ The recommendations do not address those shortcomings identified in Parts III-VI of the Report that involve general legal reform related only peripherally to microfinance. For example, the Report refers to the lack of detailed Civil Code provisions defining foundations, but the recommendations do not outline desirable features of a possible future law on foundations.

⁶⁴ The passage of amendments to the LoB would provide the MFIs with more certainty, as it is easier to repeal a normative act than a law. A normative act has the advantage of not requiring parliamentary approval.

regulation and supervision of depository institutions, as discussed further in Section VII.E.

Clarifications and Other Changes Regarding Public Associations Engaged in Microlending. A conservative interpretation of the interplay between the Law on Public Associations and the relevant provisions of the Civil Code might provide a basis for arguing that public associations may not legally have microlending as their primary activity.⁶⁵ [Law on Public Associations, Art. 6] The authors recommend amendment of the Civil Code to specify socially targeted microlending as an appropriate legal purpose of a public association. The authors also recommend amending the Civil Code so that legal entities (both resident and non-resident) may be founders and members of public associations.

Onlending Borrowed Funds. All microlenders operating without an NBT license face uncertainty regarding whether they may borrow funds and use the proceeds for onlending. Without an NBT license, a lender takes the risk that the NBT may interpret this activity to constitute unlicensed deposit-taking. To enable microlenders to raise capital and expand, it is essential that the law be clarified regarding the circumstances under which borrowed funds may be onlent without risk of triggering the requirement of an NBT license.⁶⁶ It is clear that borrowing funds for onlending from a local commercial lender, a foreign financial institution or a foreign sponsor poses no systemic risk to the Tajik financial sector. The Civil Code should therefore be amended to clarify that borrowing from these sorts of sources may be onlent without an NBT license.

Cash Collateral. At least one MFI operating in Tajikistan currently engages in the common practice of accepting repayable 'cash collateral' from clients (otherwise known as 'forced savings' or 'compensating balances') in order to enforce loan repayment. Acceptance of cash collateral should not trigger the requirement of an NBT license, provided that safeguards are in place to ensure that such funds are not onlent by the MFI in question and that the microborrowers whose cash is taken as collateral understand the risks involved. It is recommended that the Civil Code be amended to include specific requirements for cash collateral that, if followed, will not require the lender/pledgee to have an NBT license. These requirements could include placing the cash collateral in a segregated bank account or safe-deposit arrangement and prohibiting access to the funds by the lender except upon a default by the borrower.

Permits for Unlicensed Microlenders.⁶⁷ There is wide support among microfinance practitioners and public officials for a permit-issuing process whereby non-depository microlending institutions would be granted official 'permission' to operate.

⁶⁵ This concern does not extend to foundations. The Civil Code clearly permits foundations to be formed for the socially beneficial purpose of making loans to lower income individuals and microentrepreneurs, provided this activity corresponds with the foundations' purposes. [Civil Code, Art. 50(3)]

⁶⁶ This problem -- essentially, a concern with unintentionally permitting unlicensed financial intermediation -- exists in many countries throughout the world.

⁶⁷ We have not used the term "accreditation" -- which is the term used in the ADB MOU and proceedings of the May 6-7 meetings -- as this implies a kind of 'stamp of approval' that the process would not (according to the authors' recommendations) include.

The authors also support this idea. Others have suggested that only non-commercial microlenders be granted permits and all others be licensed.⁶⁸ The authors would recommend separating institutions that will be subject only to permitting from institutions that will be subject to full-scale licensing based on whether the type of institution (or the context) justifies prudential regulation and supervision. This would leave all non-depository microlenders, regardless of their legal form, subject only to a permit-issuing process. However, wherever the line is drawn, the following issues bear consideration:

- The permit-issuing process should be based on objective criteria and should not involve unnecessary administrative discretion (which would risk capricious administrative action and an unlevel playing field for applicants).
- The objectives of permitting are fundamentally different from the objectives of prudential regulation and supervision of depository financial institutions. Permitting should be transparency-driven, rather than focusing on avoiding the failure of permit-holding institutions.⁶⁹
- The data required to be granted a permit and to comply with ongoing reporting obligations should be closely linked with non-prudential objectives, such as: avoidance of money laundering, fraud and other financial crimes; avoidance of pyramid schemes and similar abusive investment schemes; provision of information to identify cases of regulatory noncompliance; and provision of general information to the public to make possible industry benchmarking and to insure robust competition.

B. Existing NBT-Licensed Non-Bank Financial Institutions⁷⁰

NBFIs under Reg. 118. Much of the current confusion over the legal and regulatory status of non-bank financial institutions results from uncertainty as to the current legal effect of NBT Reg. 118 "On Non-Bank Financial Institutions" and problems with its terms if it is indeed (or it becomes) legally effective. Reg. 118, the framework for all NBFIs (excluding credit unions), contains numerous ambiguities. It is recommended that Reg. 118 be replaced with a newly drafted NBT normative act that would address following topics (in addition to the topics presently covered):

- Clarification of the status of Civil Code lenders that are not NBT-regulated NBFIs and clear identification of the dividing lines between the two groups of financial service providers;⁷¹

⁶⁸ See Proceedings of the May 6-7 Meetings, p. 4, para. 18.

⁶⁹ This concern is especially important if the same public body bears responsibility for non-prudential permitting of non-depository MFIs and prudential regulation and supervision of depository MFIs. See the discussion under the heading "Disadvantages" in Section VIII.E.

⁷⁰ As noted in footnote 63 above, an NBFIs is by definition an NBT-licensed institution.

⁷¹ See the discussion in Section VII.A under the heading "Legal Exemption from Requirements of NBT License."

- Permission to take deposits, as contemplated by the provisions of Law on Banks that address deposits (Art. 5.3) and that generally define NBFIs (Art. 44);⁷²
- Clear resolution of the status of loan societies under Reg. 83 as either subject to or exempt from Reg. 118;

Loan Societies. A threshold recommendation regarding loan societies under NBT Reg. 83 (mentioned immediately above) is to clarify whether Reg. 118 "On Non-Bank Financial Institutions" is intended to apply to loan societies. (As noted above, if Reg. 118 is to apply to loan societies, Reg. 118 will need to be amended to permit deposit-taking.) Assuming this confusion is resolved by clarifying that loan societies are subject to an amended Reg. 118 (or an entirely new framework normative act on NBFIs), Reg. 83 and other applicable NBT normative acts should be amended to permit formation of branches by loan societies and to establish appropriate minimum capital requirements that recognize the relatively low level of systemic risk involved (given that loan societies may only accept deposits from their members). The recommended amendments to Reg. 83 should also clarify that loan societies, which must be formed as either a JSC or an LLC, are distinct from credit unions, which are organized with a one-member/one-vote ownership and governance structure.

C. Credit Unions

There is a need for either a separate law on credit unions and similar cooperative member-owned and governed depository financial institutions or an NBT normative act defining this class of institutions and their characteristics. Whether adopted as a new law or as an NBT normative act, the most critical features needed include: (1) explicit rules on formation and governance on the cooperative principle of one-member/one-vote; and (2) due attention to the special prudential treatment appropriate for the credit unions formed. The authors were informed by separate sources about two parallel initiatives already underway to address the legal status of credit unions, one through the adoption of a separate law and the other through the adoption of an NBT normative act. It is recommended the proponents of these initiatives unite forces and that technical assistance be provided to ensure that the resulting law or normative act conforms with global best practice standards for credit union legislation and regulation.

D. A Possible New Specialized 'Microfinance Bank' under an NBT Normative Act

As noted in the ADB MOU and in the CGAP report, there already is significant demand for savings services among microclients in Tajikistan.⁷³ AKDN is already far

⁷² If Reg. 118 NBFIs remain exclusively non-depository (with loan societies and credit unions excluded from the regulation's purview), the details of an appropriate permit-issuing process should be outlined, with due consideration for the issues set forth in the discussion immediately above.

⁷³ Although two existing legal vehicles -- banks and loan societies -- can offer deposit-taking and other services, these vehicles are not optimal for microfinance, as described in the paragraphs on "Shortcomings." (See Sections III.E.3 and 4.)

along in its plans to consolidate the existing microloan portfolios of its Tajik affiliates into a newly licensed commercial bank that would offer savings products. Other donors and IFIs may be interested in using a similar approach to form specialized 'microfinance banks' such as those in which EBRD and IFC have invested elsewhere in the region. As the microfinance sector in Tajikistan matures and expands, existing MFIs will also want to engage in deposit-taking and will need a convenient and appropriately regulated vehicle to do so.

Given the current underdeveloped state of institutional capacity among existing MFIs,⁷⁴ today there is not a sectoral need for a depository form of MFI into which existing MFIs would transform.⁷⁵ Meanwhile, the Law on Banks, and NBT normative acts that could be adopted under it, offer an easy approach to establishing depository MFIs that will work adequately for AKDN and others who today have the capital and technical capacity to establish such an institution. The authors recommend working with the NBT to develop an NBT normative act governing a type of 'specialized' bank with different prudential regulations from those applicable to 'universal' banks.⁷⁶ Whether or not this proposed new regulatory category is referred to as a 'microfinance bank' is less important than the specific prudential standards that would apply and range of services that would be permitted.

At least one significant obstacle to the development of a specialized 'microfinance bank' under the Law on Banks stems from a provision in the law itself (which therefore cannot be addressed by the adoption of a new NBT normative act). This is the overall quota limitation on foreign investment that applies to the Tajik banking sector.⁷⁷ The quota limitation obviously creates problems extending far beyond microfinance and requires urgent attention as part of the Tajik government's macro-level strategy to attract (rather than dissuade) foreign investment.

E. Reform under a 'Law on Microfinance Services'

The substantive recommendations set forth above all contemplate amendments to existing laws and regulations or the adoption of new laws and regulations within the existing general legal and regulatory framework of the Tajik financial sector. The same substantive changes could be implemented by the adoption of a new 'Law on Microfinance Services' (and regulations adopted under it), as is contemplated under the

⁷⁴ As stated in the CGAP report, "substantial training and technical assistance focused on institution-building is needed by almost all microcredit NGOs in Tajikistan, focused on developing staff manuals, lending procedures, business plans, accounting systems, loan tracking systems, and other institutional systems and procedures." (CGAP report, p. 18)

⁷⁵ The authors acknowledge that there are advantages to putting in place a legal and regulatory framework for a new legal vehicle before there is a demand. However, the timing and prioritization of reform measures is important. In addition, putting a framework in place does not require the adoption of new specialized microfinance legislation, as contemplated by the ADB MOU. See the discussion in Section VII.E regarding the disadvantages and advantages of the proposed 'Law on Microfinance Services.'

⁷⁶ NBT Instruction 100 uses the terms "universal" and "specialized" bank, without elaborating the distinction. The authors are not aware of any limitation on the NBT's plenary regulatory authority under the Law on the National Bank and the Law on Banks that would prevent it from establishing new regulatory categories of limited service banks, to be treated as "specialized" rather than "universal" banks.

⁷⁷ See the discussion under the heading "Ownership" in Section III.E.4.

ADB MOU. This approach – including some the specific features proposed explicitly or implicitly in the ADB MOU – presents both potential disadvantages and potential advantages that should be carefully weighed.

1. Potential Disadvantages

Relationship Between the New 'Law on Microfinance Services' and Existing Financial Sector Legislation. Adoption of a new law with a subject matter that duplicates or substantially overlaps with the subject matter of existing laws creates opportunities for unforeseen loopholes, misinterpretations and inconsistencies in application. While all of the relevant existing laws and regulations could be amended to set forth their relationship to the new legislation and the legal forms it would create, this process is likely to be as labor intensive and politically time consuming as simply amending the laws and regulations in question to incorporate the substance of the proposed 'Law on Microfinance Services.'

Even if harmonizing amendments to the existing laws were effected, the relationship between the various new forms of MFI made possible under the proposed 'Law on Microfinance Services' and financial institutions created under existing financial sector laws and regulations would be prone to misunderstanding and potential unequal treatment. It is important to recognize that creating a microfinance legal and regulatory framework alongside the legal and regulatory framework for the existing financial sector (regardless of whether accomplished by a separate law or not) does present a general risk given that the new sector will be subject to different regulation and regulatory standards. If the rules applicable to MFIs are, or are perceived as, less onerous than those applicable to mainstream financial institutions (for example, lower minimum capital requirements), existing troubled financial institutions such as undercapitalized commercial banks (as well as some unwelcome new market entrants) may attempt to take advantage of the new legal forms.

Law vs. Normative Act. The proposed 'Law on Microfinance Services' would have the disadvantage of requiring parliamentary approval, while many of the substantive changes to be implemented by the law could (as described in these recommendations) be introduced through the adoption of NBT normative acts. In fact, the Law on Banks specifically instructs the NBT to establish categories of NBFIs and the rules applicable to them through normative acts. [LoB, Art. 44.2]

The NBT as the Regulatory Agency for Overseeing all Types of MFIs. Discussions on the proposed 'Law on Microfinance Services' have thus far assumed that the NBT would serve as the regulatory oversight agency for all types MFIs, including both commercial and non-commercial organizations and both depository and non-depository institutions. Assigning a single regulatory agency with the responsibility for issuing permits to, regulating and supervising (as appropriate) all of the different types of MFIs presents the risk of confusion on the part of the regulator as well as the MFIs

themselves.⁷⁸ This risk is heightened in the present context, as the NBT staff is new to microfinance and still needs significant training on the basics of risk-based supervision of depository institutions.

Although the discussions of the proposed 'Law on Microfinance Services' have not been explicit on the subject,⁷⁹ the implication has been that the proposed law would sweep all MFIs under the regulatory jurisdiction of the NBT, treating them all as newly defined types of NBFIs. In other words, there would no longer be a class or classes of Civil Code microlenders, but only various kinds of NBT-regulated NBFIs engaged in crediting rather than lending activities. While the rules applicable to the simplest forms of MFI could be designed to protect to the extent possible against over-regulation, the risk could remain significant.

It should be noted that the disadvantages of consolidating differing kinds of regulatory responsibility in a single regulatory agency are not an inherent feature of the proposed 'Law on Microfinance Services.' The proposed law could be drafted to assign to the NBT only prudential regulatory responsibility over depository institutions, while leaving the issuing of permits to non-depository institutions to another regulatory agency. Alternatively, the NBT could be given responsibility for both prudential regulation of depository institutions and the issuing of permits to commercial non-depository NBFIs, while leaving NGO microlenders to operate as Civil Code lenders, operating with permits issued by another regulatory agency or without permits altogether.

2. Potential Advantages

A Single Main Piece of Legislation. The proposed 'Law on Microfinance Services' could be drafted to eliminate many of the most significant perceived barriers to microfinance in one piece of legislation and related amendments to other laws and regulations. However, this advantage is not as significant as it might first appear in view of the fact that each of the other major laws and regulations affecting microfinance would still have to be amended to be harmonized with the new law.

Potentially Lower Scrutiny During the Parliamentary Process. If the amendments to other key legislation – such as the Law on Banks and the Civil Code – can be explained as necessary merely to harmonize with the 'Law on Microfinance Services,' they may attract less rigorous scrutiny in the parliamentary process than they would if they contained more substantive amendments.

Advantages of NBT Jurisdiction. The risk of confusion that might result from the NBT being the sole regulator of all forms of MFI might be countered to some extent by the economic efficiencies of consolidating administration in a single body. It may

⁷⁸ Where a central bank such as the NBT is assigned oversight responsibility over non-depository financial institutions, there is also the risk that the general public may see the central bank as vouching for the financial health of the institutions in question.

⁷⁹ The various papers (ADB MOU; proceedings of the May 6-7 conference, including the NBT statement; draft outline for the 'Law on Microfinance Services') do not specify whether microlending organizations would be defined as credit institutions.

also be that the NBT has a comparative advantage in terms of the level general knowledge of the financial sector and financial transactions when compared with other possible contenders for regulatory jurisdiction over non-depository institutions.

NBFI Status for All Forms of MFI. Treating all forms MFI as NBFIs – rather than defining a separate class or classes of Civil Code lenders that would not be treated as NBT-regulated NBFIs – would have the advantage of automatically extending to all these types of institutions the tax and accounting treatment accorded to regulated financial service providers.

F. Other Legislative Amendments

1. Clarification of Registration

Although the Civil Code provides for a unified state registry with the Ministry of Justice and specifies that the registration procedure is to be set forth in a law on registration of legal persons, the 1991 Law on State Registration of Enterprises (last amended in 1997, before adoption of the Civil Code) does not provide for such procedures. Instead, the registration procedures, including the governmental body responsible for registration, depend on the type of legal form. The Law on Public Associations provides that national public associations are registered with the MoJ and local public associations are registered with the Department of Justice of the relevant *khukumat*. There is no specific law governing foundations; thus, in the absence of an amendment to the Law on State Registration of Enterprises, foundations follow the general provisions of the Civil Code. The Law on JSCs sets forth the procedures for registration of JSCs by the MoJ. (Presumably, the newly adopted and not yet translated Law on LLCs has a similar provision.) Banks and NBFIs are registered with the NBT pursuant to the Law on Banks (and in contradiction to the Civil Code).

As international practice would favor one registry and as the registration provisions of the Law on Banks (designating the NBT as the body responsible for registering banks and NBFIs) are in conflict with the Civil Code registration provisions, the authors recommend amending the Law on State Registration of Enterprises to provide for a uniform registry covering all legal entities including banks and NBFIs.

2. Tax Treatment of MFIs and Microfinance Activities

There are five issues of primary concern regarding the tax treatment of MFIs and microfinance activities (as identified in Section VI). The first two extend far beyond the microfinance sector and are unlikely to be meaningfully addressed as an aspect of microfinance-related legal and regulatory reform:

- *Overall tax burden.* The overall tax burden on all businesses, including both MFIs and their clients, is extremely high. The government has recognized the importance of this problem in its draft policy on microfinance services prepared in connection with the May 6-7 meetings. However, this issue

obviously has tremendously broad implications and cannot easily be addressed piecemeal. The most realistic strategy is therefore to attempt to insure that the microfinance sector has a 'seat at the table' and is not forgotten when broader tax reform is undertaken.

- *Uneven treatment of international and local institutions based on bilateral agreements.* There is an uneven playing field among MFIs, owing to the effect given to bilateral agreements between donors or IFIs and the government. Unfortunately, this issue is difficult to address because of the varying provisions in bilateral agreements that different donors and IFIs have already concluded with the government.

The remaining three issues *could* all be addressed meaningfully as an aspect of microfinance-related legal and regulatory reform:

- *Profits tax treatment of microcredit NGOs.* Currently, no Tajik nonprofit is exempt from profits tax. The authors make no specific recommendation as to whether to exempt NGOs engaged in microlending from profits tax, but instead recommend that the following issues be considered by Tajik policymakers. The decision whether to provide for, and how to delineate, profits tax exemption for microcredit NGOs should be made with due attention to *targeting* the subsidy provided to organizations whose lending activities provide demonstrable public benefit and to harmonizing the treatment of microcredit NGOs with the treatment of economic activity by other forms of public benefit NGOs. In delineating profits tax exemption for microcredit NGOs, the potential for abuse should also be borne in mind, and its potential to harm the reputation of the microfinance sector generally. In addition, if such institutions are given tax exempt status, then the regulatory oversight of microlenders presents the risk that the tax authorities will use information gained to go after their microclients.
- *Calculation of profits tax for unlicensed lenders.* Ambiguities exist as to the deductibility, for profits tax purposes, of expenses associated with lending in the case of lenders not licensed by the NBT as banks or credit institutions. In addition, the authors have been informally advised by the ADB that the net income of banks may be placed in a capital reserve (thereby avoiding taxation, provided that if they are distributed as dividends at any point in the future, they will be subject to tax).⁸⁰ The authors recommend that the playing field be leveled for all lenders and creditors subject to profits tax by extending the current treatment of NBT-regulated banks and credit institutions to Civil Code lenders. It is recommended that the Tax Office be asked formally whether this change falls within its power to adopt through an interpretive release or by normative act (as the alternative – amendment of the Tax Code – would be

⁸⁰ If the net income were distributed as dividends or kept as retained earnings, it would be subject to profits tax. The ADB did not identify the provision of law or regulation providing for this treatment of reserves, and it may be that it finds its legal basis in Art. 135 of the Law on Banks, which provides for deduction of moneys allocated to a reserve fund for bad debts, as discussed in Section V.C.

much more time-consuming and the results subject to the political uncertainties of the parliamentary process).

- *VAT treatment of unlicensed lenders.* The Tax Code defines "crediting" -- but not lending -- as a financial service (and thus not subject to VAT). (This impacts both loans and collateral on loans.) Loans should be subject to the same VAT treatment as credits. It is recommended that the Tax Office be asked formally whether this change falls within its power to adopt through an interpretive release or by normative act (as the alternative -- amendment of the Tax Code -- would be much more time-consuming and the results subject to the political uncertainties of the parliamentary process).

3. Collateral

The shortcomings of existing law regarding collateral identified above -- the absence of a comprehensive system of collateral registry, the lack of workable means of pledging intangibles such as business receivables, the lack of a simple and economic means of enforcing collateral interests -- are issues that require significant resources to address. In addition, although the Civil Code permits cash collateral for loans, the requirements are not set forth; thus, there is a lack of clarity regarding circumstances under which acceptance of cash collateral might be considered deposit-taking requiring an NBT license.⁸¹ Fortunately, there are at least two separate efforts planned for dealing with the collateral law issues: the World Bank's Financial Institution and Enterprise Support Project and the CLP's planned project. The authors recommend that the microfinance sector leave this broad topic of reform to these well-resourced initiatives.

G. Harmonization

Significant risks to the Tajik financial sector will likely result if microfinance legal and regulatory reform is not closely coordinated with broader financial sector reform. In particular, if the approach taken implementing many of the sound microfinance policy objectives that the government has announced is a wholly separate system of new forms of financial institutions, created parallel to the underdeveloped and weak existing mainstream financial sector, the adverse effect on the latter is likely to be significant. The possible adverse effect is even more likely if scarce supervisory resources of the NBT are redirected from the existing financial sector to the microfinance sector.

These problems are likely to be averted only through carefully designed plans to integrate and harmonize microfinance-related legal and regulatory change with reform of the mainstream financial sector and the laws and normative acts that govern it. The microfinance sector, too, stands to benefit from this approach. If commercial banks are strengthened, they become more viable partners for developing MFIs and realistic candidates for microcredit onlending programs that have been highly successful in other

⁸¹ Other than the last point mentioned above, all of the collateral law issues are relevant to anyone taking security, and are therefore not only of importance to the microfinance sector.

countries in the region. Conversely, threats to safety and soundness of mainstream financial institutions will also threaten the nascent microfinance sector.

Appendix A Sources Consulted

Legislation⁸²

Law on Banks and Banking Activities, May 23, 1998
Law on the NBT, Dec. 14, 1996 plus amendments on Dec. 14, 1996 and amendments (**) on May 12, 2001
Civil Code, June 30, 1999 for Part I; Dec. 11, 1999 for Part II
Tax Code (1999) plus amendments (**) through August 6, 2001
Law on Joint Stock Companies plus amendments (**) through May 22, 1998
Law on Foreign Investment plus amendments (**) through Dec. 11, 1999⁸³
Law on Bankruptcy of Enterprises dated March 10, 1992 plus amendments (**) through May 22, 1998
Law on Mortgage (June 20, 1994) plus amendments (**) adopted May 22, 1998

In Russian only:

Law on State Registration of Enterprises, Feb. 21, 1991 plus amendments dated Dec. 12, 1997**
Law on Public associations May 23, 1998**
Law on Foreign Economic Activity dated Dec. 27, 1993 **
Law on Competition and Limitation of Monopolistic Activities in the Goods Markets dated November 10, 2000
Law on State Fees dated Jan. 6, 1992**
Law on Insurance, June 20, 1994 plus amendments through May 14, 1999 **

NBT normative acts

Reg. 83 *On Loan Societies* (issued Jan. 26, 1999, amended (**) June 4, 1999)
Reg. 94 *Regulation on Incorporation of Credit Entities (Non-Banking Companies)* approved by the NBT on January 5, 2000
Reg. 112 *On Cash Accounts and Transfers in the Republic of Tajikistan* (approved by NBT on March 1, 2001 by Decree 62) **
Reg. 118 *On Non-Bank Financial Institutions* (approved by Decree 19 on Jan. 28, 2002; submitted to MoJ for registration)

Instr. 51 *On Inspection of Banks* (approved by NBT on Sept. 16, 1997 by Decree 51) ** approved by the Decision of NBT Board No. 51 dated September 16, 1997 with the amendment 1 dated August 2, 1999**

Instr. 79 *Regulation Procedures of the Credit Institutions Activity* approved by the Decision of the NBT Board dated April 4, 1999 with amendments and modifications No. 1 dated July 28, 1999, No. 2 dated August 2, 1999, No. 3 dated February 7, 2000, No. 4 dated November 14, 2000, No. 5 dated January 26, 2001 and No. 6 dated November 10, 2001 approved by the relevant Decisions of the NBT Board.

⁸² The asterisk (**) indicates that the legislation or normative acts were translated into Russian but not into English.

⁸³ Parliament has recently passed amendments to this law; however, neither the authors nor CLP were able to get copies of these amendments.

Instr. 100 *On Registration of Banks, their Subsidiaries and Licensing of Banking Activities within the Territory of the Republic of Tajikistani* (approved by the NBT on April 29, 2000 by Decree 48; amended Sept. 28, 2001) **

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Secondary Materials

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"Towards the establishment of a microfinance bank sponsored by the Aga Khan Development Network (AKDN)"

Appendix B
Persons Consulted

AMIROV, Mr. Rakhmonali – Director of the Anti-Monopoly Agency

ASHUROV, Akmaljon – Legal Specialist for Banking Supervision Department, National Bank of Tajikistan

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BOTHA, Mr. Gerhard – Financial Sector Specialist, World Bank

DAVLYATOV, Mr. Shamsullo – Head of Legal Department, National Bank of Tajikistan

DAVLYATOV, Mr. Jumakhon – Chief of Legal Department of the Presidential Office

ESHOV, Mr. Djuma K. – Deputy Chairman, National Bank of Tajikistan

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Appendix C

Current Legal and Regulatory Reform Initiatives Affecting Microfinance

As a result of a donors' microfinance seminar convened by CGAP and others in Dushanbe in February 2002, the donors agreed to cooperate and coordinate their efforts on various matters, including developing an appropriate legal and regulatory environment for microfinance.⁸⁴ The donors established a Legal and Regulatory Working Group, to be chaired by ADB, which agreed to meet quarterly to coordinate their work. In addition, a group of MFIs formed the MFI Coordination Group comprised of the existing NGOs (including the international NGOs and their local partners), various government ministries, IFIs and donors. This group meets monthly to discuss legal and regulatory issues and other matters of concern to their operations.

The current state of affairs regarding microfinance-related legal and regulatory policy reform is as follows:⁸⁵

Legal and Regulatory Working Group. The first of the planned quarterly meetings of this working group was held on May 6-7, 2002. The NBT introduced the government's proposed policy on microfinance services (discussed below) and representatives of various MFIs (including representatives of the MFI Coordination Group)⁸⁶ articulated their legal and regulatory policy-related concerns. In addition, following the meeting, the ADB and the Tajik government agreed to the terms of a Memorandum of Understanding on the ADB Microfinance Systems Development Program (discussed below).

Government Policy on Microfinance Services and involvement in legal and regulatory reform. In the draft policy statement prepared in connection with the May 6-7 meetings, the government, represented by the NBT, focused on five primary problems: (i) the lack of appropriate legislation on microfinance, (ii) the uneven tax applied to different MFIs (primarily due to the exemptions applicable to MFIs protected by bilateral agreements), (iii) the lack of clear legal and regulatory treatment of NGO MFIs, (iv) the unsustainable situation of existing MFIs that are dependent on donor financing and (v) lack of public information about the MFIs. According to the government's draft policy, it plans to take the following measures to address the legal and regulatory issues:

- create appropriate enabling legislation for the operation of MFIs and harmonize existing legislation,
- simplify and lower the tax burden of MFIs and their clients,

⁸⁴ The following donors participated: ADB, AKDN, Aga Khan Fund for Economic Development, Eurasia Foundation, GTZ, IFC, OSI/Soros Foundation, UNDP, USAID, World Bank. In addition, more than 30 policymakers and representatives of MFIs attended.

⁸⁵ The list below does *not* include the microfinance-related projects and initiatives that do not involve legal and regulatory reform work. The World Bank, IFC, USAID, ADB, AKDN, the Eurasia Foundation, OSI/Soros Foundation and the Islamic Development Bank, among others, are all developing microfinance-related projects or initiatives outside the legal and regulatory reform arena. A more complete list appears in the CGAP report.

⁸⁶ In the Summary of the Proceedings of the May 6-7 meetings, the MFI Coordination Group is referred to as the "Coalition of non-commercial organizations implementing microfinance programs in Tajikistan."

- establish a department in the NBT to oversee MFIs and
- simplify and lower the costs of legal processes associated with collateralization.

The NBT is taking the lead role in the development of the government's position on microfinance-related legal and regulatory policy and implementation of that policy. The NBT has specifically identified the end of calendar year 2002 as the date by which it hopes to have microfinance-related legislation ready for parliamentary approval. [Interview with Juma Eshov, May 28, 2002] The intention is to rely primarily on a local drafting team, including lawyers within the NBT and also experts participating in a microfinance legal and regulatory "think tank" convened by OSI/Soros Foundation (discussed below), with input from international microfinance legal experts. [Interview with Juma Eshov, May 28, 2002; interview with Shamsullo Davlyatov and Akmaljon Ashurov, May 28, 2002]

In recognition that rapid progress on microfinance-related legal and regulatory reform will require more coordination than the planned quarterly meetings of the Legal and Regulatory Working Group, the NBT plans to appoint a coordinator to assume a day-to-day role in this process. [Interview with Juma Eshov, May 28, 2002] The NBT's steps to assume a coordinating position with respect to microfinance-related legal and regulatory reform have been heralded by donors [interview with Gerhard Botha, Paula Genis and Ram Janakiram, May 27, 2002; interview with Kimberly Rosen, Michael Harvey and Lewis Tatem, May 30, 2002] who wish to see microfinance-related reform efforts undertaken with due attention to broader questions of financial sector and commercial law reform. Donors also expressed the hope that the planned coordinator position will facilitate communication among a variety of substantively related initiatives, including banking law and regulatory reform, tax reform, collateral law reform and reform efforts focused on the business environment for entrepreneurs.⁸⁷ [Id.]

MFI Coordination Group. The MFI Coordination Group articulated several legal and regulatory concerns at the May 6-7, 2002 meetings, including:

- the general need for a clear legislative framework (notwithstanding that the Civil Code permits NGOs to provide certain financial services),
- the need to clarify the legal status of NGO MFIs regarding (i) whether commercial or non-commercial; (ii) whether an NBT license is needed; and (iii) whether to register with the MoJ or the MoF,

⁸⁷ It is also hoped that the NBT-appointed coordinator may help to harmonize reform efforts stemming from different parts of the government and other public bodies, in addition to coordination assistance provided by the MPSC. At present, other public bodies besides the NBT are pursuing reform plans that overlap with the areas identified in the government's draft policy statement presented by the NBT at the May 6-7 meetings. These include plans by the Agency for Anti-Monopoly Policy, Consumer Protection and State Support of Entrepreneurs to draft and introduce (through parliament, if there is insufficient interest within the government) a separate law on microfinance activities. [Interview with Rakhmonali Amirov and Davlyatmurod Jumaev, May 27, 2002] The Agency for Anti-Monopoly Policy, Consumer Protection and State Support of Entrepreneurs has also played an instrumental role, with support from IFC, in the development of a draft leasing law that is presently under consideration by the government. [Id.]

- the need for a variety of improvements in the tax situation of MFIs, including profit tax exemption for non-commercial NGO MFIs and clarification that loans are a financial service for tax purposes (and thus should not be subject to VAT).

OSI/Soros Foundation. OSI/Soros Foundation has convened a group of lawyers, law professors and public officials with particular expertise in financial sector matters to serve as the core of a "think tank" on microfinance legal and regulatory issues.⁸⁸ [Interview with Zuhra Halimatov and Firuz Sattarov, May 24, 2002] The group has already held several workshops that touch on legal and regulatory issues of concern to the development of microfinance in Tajikistan. [Id.] Future planned activities of the group include assistance to NBT lawyers in the preparation of microfinance-related legislation. [Id.; Interview with Shamsullo Davlyatov and Akmaljon Ashurov, May 28, 2002]

OSI/Soros Foundation has also played, and expects to continue to play, an important role in facilitating dialogue among donors, practitioners and public officials. This included funding preparation of the May 6-7 meetings and assistance to the government in the preparation of its draft microfinance policy statement.

ADB. The ADB Microfinance Systems Development Program includes a policy loan and an investment loan. The ADB MOU contemplates the following legal reform-related measures under the policy loan in 2002: (i) establishment of a Government policy on microfinance, (ii) drafting of a new Law on Microfinance Institutions (which would provide, among other things, for a depository microfinance vehicle) and clarification of registration requirements for MFIs, (iii) the establishment of a tax environment supportive to the development of MFIs, (iv) the establishment of a microfinance policy steering committee and an NBT/Government/NGO technical working group and (v) the establishment of MFI supervisory capacity within the NBT. The second tranche of funding under the policy loan would be conditioned on the following (all planned to occur in 2003): adoption of the proposed Law on MFIs; amendment of all necessary provisions of the tax code; approval by the NBT of regulations applicable to MFIs; and licensing by the NBT of two deposit-taking MFIs.

USAID.⁸⁹ USAID is already actively supporting a variety of legal and regulatory reform initiatives with relevance to microfinance, including banking law and regulatory reform, tax reform, collateral law reform and reform efforts focused on the business environment for entrepreneurs. Following the February 7 donor microfinance seminars, USAID sponsored a visit of key Tajik policymakers to Kyrgyzstan in order to learn about Kyrgyz microfinance-related legal and regulatory reform work. In late May, USAID met with the NBT to discuss a formal memorandum of understanding pursuant to which USAID would support the legal and regulatory reform measures planned under the ADB

⁸⁸ The convening of the "think tank" is an outgrowth of the NIS Policy Forum on Microfinance Law and Regulation held in Krakow, Poland in June 2001, sponsored by OSI/Soros Foundation, USAID and the Day, Berry & Howard Foundation.

⁸⁹ USAID provided financial support for the preparation of this Report, through a grant to MFC. In addition to its support of microfinance-related legal and regulatory reform, USAID is also providing funding for technical assistance and loan capital for MFIs.

Microfinance Systems Development Program. (Specifically, it is envisioned that USAID will provide assistance in drafting (i) a law on microfinance institutions and (ii) amendments to the various pieces of legislation needed to harmonize the law on microfinance institutions with existing legislation and to clarify other legal ambiguities relevant MFIs.) USAID's further plans for assistance on the legal and regulatory framework for microfinance and related reform initiatives are under development.

World Bank.⁹⁰ The World Bank's Farm Privatization Support Project (FPSP), under implementation since 1999, includes "the development of appropriate rules, regulations, registration requirements and eligibility criteria governing the operations of rural savings and credit associations [as well as] training in supervision and enforcement of guidelines for the staff of NBT." [CGAP report, pp. 25-26] In addition, the World Bank's Financial Institution and Enterprise Support Project (FIESP), which is scheduled to be presented to the World Bank's Board 2003, will support "systematic development of the legal and institutional framework of the financial and private sector."⁹¹ [Id. pp.26-27]

IFC. As mentioned above, IFC is working with the Agency for Anti-Monopoly Policy, Consumer Protection and State Support for Entrepreneurs on project to promote a legal and regulatory framework for leasing.⁹² [Outcomes paper, p. 1; Interview with Rakhmonali Amirov and Davlyatmurod Jumaev, May 27, 2002] IFC has also expressed interest in supporting the development of a depository form of MFI. [CGAP Report, p.16]

⁹⁰ This description of aspects of World Bank legal and regulatory reform projects is based primarily on the summary in the CGAP report.

⁹¹ The World Bank's planned Second Poverty Alleviation Project (SPAP) is also expected to include a credit line to eligible MFIs. [CGAP report, p. 26] In addition, under the auspices of the FIESP, a credit line to commercial banks will provide capital for onlending to micro, small and medium-scale enterprises, [Id. pp.26-27] which may include strong performing MFIs. [Interview with Gerhard Botha, Paula Genis and Ram Janakiram, May 27, 2002]

⁹² IFC is discussing investing in microleasing with NABW.