



**ACDIVOCA Supporting the Evolution and Sustainability
of the Bai Tushum Financial Foundation
October 1, 2000 – August 31, 2005**

FINAL REPORT

COOPERATIVE AGREEMENT No. 116-A-00-01-00027-00

Submitted to USAID/CAR

Submission date: November 1, 2005

This report is presented to USAID/CAR in compliance with the Cooperative Agreement No. 116-A-00-01-00027-00. The report presents the overview of achievements in making Bai Tushum a successful and sustainable microfinance institution in Kyrgyzstan. This report is framed in terms of the objectives formulated in the original proposal, and proceeds from the analyses of those objectives to a discussion of the successes and challenges, current state and the future of the Bai Tushum Financial Foundation using the CGAP's institutional assessment framework.

BACKGROUND

Farmers, livestock breeders, and other micro, small and medium enterprises had limited access to the credit and other financial services after the independence of Kyrgyzstan. During the first decade of independence the commercial banks were reticent about lending to agricultural and rural sector. A recent survey shows, "Limited access to business finance is identified by 74% of businesses as one of the top three problems for business, followed by the limited market in the Kyrgyz Republic (identified by 56%) and tax and customs barriers (identified by 36%). Friends and relatives are the main source of external finance, with 31% receiving finance from this source. Only 15% of businesses have used financial institutions and the majority has not used any external finance. However, these figures show an increase in the use of financial institutions since the first survey, when only 12% reported using external finance."¹

Responding to the urgent needs of this underserved strategic sector, ACDI/VOCA began rural finance programs in 1997 using financial resources generated under the USDA "Food for Progress" Monetization Program for lending capital and operating subsidies. Three independent programs successfully operated in Osh, Jalalabad and Chui oblasts for several years.² The Swiss *Caritas* had established a similar program in Jalalabad oblast, which was funded by the Swiss Agency for Cooperation and Development (SDC).

Initial success of these lending programs was soon plagued by a variety of problems. Underperformance of these programs was attributed to fragmented internal systems and lack of indigenous expertise in credit: Loan officers were accustomed to working in banks where their role was essentially to rubber stamp credit decisions made by bank directors. They had no training in risk analysis or managing delinquencies. And, because their job was to carry out decisions made by others, loan officers were not accustomed to taking responsibility for their work.

These associations ran into several legal problems due to their organizational structure. The Kyrgyz Ministry of Justice belatedly informed that farmers' associations could not be legally owned by the founders, and the donors "enjoyed" unlimited liability.

Therefore, ACDI/VOCA decided to, to consolidate these associations into a single entity, called *Bai Tushum*³ Financial Fund with the intent to create a sustainable rural and microfinance institution. By listening to stakeholders, developing new systems and training staff, *Bai Tushum* was able to develop creative approaches to addressing the above mentioned challenges. *Bai Tushum* needed to build a capable, reliable credit staff that could make sensible loan decisions and effectively administer and monitor their portfolios.

ACDI/VOCA fielded a long-term Technical Advisor Muhammad Junaid to facilitate the process of merger under USAID/CDP. The TA was instrumental in working with the organization to restructure its products and processes. After the successful merger and creation of *Bai Tushum*, USAID/CAR

¹ The survey titled National Business Opinion Survey in Kyrgyz Republic was conducted by PROMA, in June 2003 for the Tacis SME Development Program.

² Osh Farm Credit Association, Agro Credit Jalalabad Association and Chui Farm Credit Association were established in Osh, Jalalabad and Bishkek respectively.

³ *Bai Tushum* is a Kyrgyz phrase meaning "Rich Harvest". This represents aspirations of *Bai Tushum*'s staff and clients.

continued to finance technical assistance until September 2004. SDC also provided technical assistance for the initial two years of *Bai Tushum's* life.

ACDI/VOCA's Technical Advisor provided strategic and operational support to the management team of *Bai Tushum*. In addition, during the life of project the following ACDI/VOCA head office staff members provided consultancy and oversight of the project:

- **Nadia Namken**, Associate Director, E&A Division
- **Naya Kenman**, Director, E&A Division
- **Jeff Singer**, Director, E&A Division
- **Elena P. Nelson**, Assistant Vice President, Rural Finance
- **Janice Stallard**, Regional Director, CAMFA
- **Olaf Kula**, Technical Advisor, Rural Banking
- **Dr. Fred Smith**, Vice President, E&A Division
- **Dennis DeSantis**, Senior Vice President, E&A Division.

Before starting *Bai Tushum* operations, Technical Advisor drafted a charter for *Bai Tushum*; got *Bai Tushum* registered with the Ministry of Justice; constituted a Supervisory Board, and put a management team in place. All assets, including the loan portfolio of the Founders' credit programs were transferred to the new consolidated entity. A portfolio audit was conducted by independent auditors⁴. To give the new MFI a clean start, the portfolio was revalued at collectible value.

KEY PROJECT ACCOMPLISHMENTS

Under the Supporting the Evolution and Sustainability of the Bai Tushum Financial Foundation project, ACDI/VOCA has assisted the Bai Tushum Financial Foundation to:

- Become 181% percent operationally and 168% financially sustainable⁵;
- Achieve a 10% percent Return on Assets and 15% Return on Equity, well above the proxy market costs of funds in Kyrgyzstan (5%) and inflation rate (4%), which makes BTFF very attractive for institutional investors and/or acquisitions;
- Build and maintain an outstanding loan portfolio of over 5 million U.S. dollars extended to 2,740 clients with Portfolio at Risk > 30 days at 2 per cent;
- Serve 7,415 total clients;
- Attract over 4 million U.S. dollars in grants and loans to BTFF.

As a result of the ACDI/VOCA technical assistance Bai Tushum has become a financially sustainable, stable and leading financial institution that supports rural enterprises in Kyrgyzstan.

ACDI/VOCA accomplished the following objectives formulated in the original proposal:

Accord the highest priority for credit activities that promote the SME sector in the rural and urban economy, improve efficiency in the agricultural sector, promote the hospitality and tourism industry, and help reduce poverty by creating employment. BTFF provides short and medium term loans to for crop producers, livestock breeders, agro-processing units, traders, tourism service and hospitality, and other eligible SMEs with loans ranging from US\$400 to \$20,000. BTFF, through its lending programs has been able to create a large number of employment opportunities in the rural areas, especially in the southern region of Kyrgyzstan. It is estimated that for every 250 US dollar invested in lending capital ACDI/VOCA and BTFF have provided (or sustained) employment to one person. In addition to creating permanent employment (in many cases for the young men and women of the family), these SMEs and farm enterprises also provide seasonal employment to a large number of people in planting, harvesting, and marketing seasons. For example it is estimated that in Osh

⁴ Jacobs Audit audited the loan portfolio, and found that about 80% of the total value of loans was collectible, except for the "Old" Caritas portfolio where about 70% loans had to be written off.

⁵ Ratios are calculated as of June 30, 2005. Absolute numbers (portfolio, etc.) are as of August 30, 2005.

oblast an average farm enterprise funded by the BTFF provides a seasonal employment to about 12 people during harvesting of cotton. In May 2003, in recognition of BTFF's contribution to poverty alleviation in Kyrgyzstan, two BTFF senior staff and ACDI/VOCA Long Term Technical Adviser to BTFF received presidential awards from President Askar Akaev.

Develop new loan products that i) reduce transactions costs and facilitate broader participation in rural financial markets; ii) permit the profitable use of larger loans and longer terms; and iii) expand the ability to secure transactions by using real and personal property, receivables and other assets as collateral. To reach more clients and respond to the changing needs of the repeat borrowers, BTFF constantly revisits its lending methodologies and introduces new products. In addition to its traditional crop production, livestock and SME loans, BTFF introduced a number of new products that include housing loans, equipment loans, and consumer loans. To reach rural women that do not have collateral and promote self employment among them, BTFF also developed a new group-based loan product that uses a group of borrowers as social collateral.

Streamline management by implementing policies and procedures, including the development of "best practices" management manuals. ACDI/VOCA assisted BTFF with the development of policies and procedures based on "best industry practices". The list of manuals and procedures includes but is not limited to: a) personnel policies that ensure professional staff growth at all levels; b) a credit manual that contains provisions on lending procedures, client eligibility, loan portfolio classification and other issues; c) separate policies for individual loan products; d) regulations on BTFF's credit committee; e) regulations on the internal audit department; f) policies for risk management; g) regulations on the assets and liability committee; h) policy for asset and liability management and i) accounting policies and procedures. A full list of manuals and other key documents developed with ACDI/VOCA assistance is provided in Annex 1.

Expand the portfolio at a preferable rate of \$1 million per year over the next three years. Over the last four years, BTFF portfolio has grown from 1,092,203 US dollars in October 2001 to 5.2 million US dollars as of August 31, 2005, and has over 2,740 active clients. From October 1, 2001 to August 31, 2005 BTFF disbursed 14,684,127 US dollars to 7,415 clients.

Mobilize financial resources to both expand the capital base and support the technical assistance efforts. ACDI/VOCA assisted BTFF in securing grants for the development of new products, product costing and a rating from the EU TACIS and CGAP. ACDI/VOCA has been instrumental in identifying scholarships for BTFF staff training and participation in industry conferences and summits. ACDI/VOCA's Long Term Technical Advisor assisted BTFF in obtaining commercial credit lines and loans from Dexia Blue Orchard, HIVOS/Triodos Bank Fund, Kyrgyz Investment and Credit Bank, Frontiers LLC as well as a half a million US dollar guarantee fund from DCA and a local currency credit line from Demir Bank as part of a hedging arrangement to reduce foreign exchange risk. Recently, BTFF has been approved for the EBRD's 3-year \$2 million loan. Within the framework of the agreement, EBRD will provide technical assistance to BTFF with the transformation into a commercial deposit taking entity. \$1.2 million 5-year loan from the IFC is in the process of approval. IFC has also expressed its interest in taking an equity position in the commercial entity to be created by BTFF and contribute up to 15% of total capital. To further expand its capital base, BTFF's Supervisory Board approved the management plan for transforming BTFF into a commercial deposit taking entity. The detailed transformation plan is provided in Annex 2 and includes BTFF draft charter and Legal Agency Veritas legal opinion.

Rated "A" in 2002 and "A+" in 2005 by Microfinanza, Ltd., and with returns on equity and assets above inflation rates and the market costs of funds, BTFF is an attractive subject for potential outside investors and/or acquisitions.

Continue to support licensing and regulations of the National Bank of Kyrgyz Republic (NBKR) on Specialized Credit Institutions (SCI). Bai Tushum maintains good working relationship with NBKR. ACDI/VOCA through its Long Term Technical Advisor worked in close cooperation with NBKR during the development of the law on microfinance institutions and subsequently assisted NBKR in

developing the normative documents. To share information and provide know-how on the microfinance sector, Long Term Technical Advisor arranged several workshops and participated in Board meeting of NBKR as an invited guest. Currently, BTFF is participating in the NBKR working group for formulating the 5-year strategy for microfinance. The NBKR is expected to review and approve the final version of the strategy in October 2005. BTFF expressed its interest in participating in the strategy implementation group.

Maintain attention on tax and other implications of changing the BTFF's legal structure, e.g. to become a joint stock company, in order to secure equity investments. It has become evident to BTFF that donor funding and debt capital are limited. As BTFF has expanded it found that it can not sustain its growth with only these two kinds of capital. Having conducted a study of the Kyrgyz Republic's tax and legal environment, ACDI/VOCA recommended that for BTFF to attract equity investors, take deposits and engage in other banking operations, it needs to transform into a for-profit legal entity with a goal to meet all regulatory requirements for obtaining a deposit-taking license from the NBK. With assistance from ACDI/VOCA's staff; John McNulty, a transformation consultant; and VERITAS Law Firm, BTFF researched various options to achieve that goal. The following has been determined as the optimal strategy for achieving BTFF's transformation objectives:

Stage One: BTFF shall establish a wholly owned Limited Liability Company - the Microcredit Company "Bai-Tushum and Partners" LLC -- January 2006.

Stage Two: Convert the Limited Liability Company, the Microcredit Company "Bai-Tushum and Partners", into a Closed Joint-Stock Company the Microcredit Company "Bai-Tushum and Partners" - October – November 2007.

Stage Three: Transform the Closed Joint-Stock Company Microcredit Company "Bai-Tushum and Partners", into a Closed Joint-Stock Company, the Microfinance Company "Bai-Tushum and Partners" - January 2008.

Annex 2, titled "BTFF Transformation Strategy" describes the regulatory requirements, legal and financial aspects of the transformation process that BTFF will go through in the next 3 years.

The following paragraphs provide more detail on the project achievements, the current state and future plans of the BTFF using the CGAP's institutional appraisal framework.

1. VISION AND MISSION

To chart the future, in the very first *Bai Tushum* Supervisory Board meeting, the Technical Advisor presented a "vision paper" to the Supervisory Board. The paper identified the following strategic objectives for *Bai Tushum*:

1. to build a superior quality, diverse loan portfolio in the various regions of Kyrgyzstan;
2. to generate financial resources and provide profitable investment of *Bai Tushum*'s funds;
3. to encourage profitable extensions of credit that meet the legitimate needs of the *Bai Tushum*'s market;
4. to impact the *Bai Tushum* clients' and their families' lives.

Accordingly, the following vision and mission statements were drafted:

Vision: *Bai Tushum* envisions a prosperous Kyrgyzstan where the country's entire population has access to reliable financial services.

Mission: *Bai Tushum* is "dedicated to the social and economic development of both the rural and urban sectors of the Kyrgyz Republic through the:

- lending, with interest, of its funds to individuals and institutions,
- provision of technical and other services related thereto, and
- Investment of funds in organizations that advance its goals and objectives."

1.1. Legal and Business Organizational Form

At the time of merger of the constituent credit programs, there was no precedent of a microfinance institution in Kyrgyzstan registered under the local laws in private or NGO sectors with exception of Kyrgyz Agricultural Finance Company K AFC, which existed under a special legislation. Adopting that model for new institution was neither possible nor desirable.

The Founders determined that it is important to find a workable business organization for the proposed consolidated institution. They weighed the benefits and constraints of three types of legal entity: Joint Stock Company, Credit Union, and Public Fund. Given the mandate of the donors, ease of formation, cost effectiveness, and operational sustainability, the Founders decided to take the Public Fund route, and consequently registered *Bai Tushum* Financial Fund, as a non-commercial public foundation with the Ministry of Justice. This registration authorized Bai Tushum to perform lending operations using its own funds only. Bai Tushum was required to pay all taxes including the profit tax. It could not, however, treat its loan loss provision as deductible expense.

After formation of new institution ACDI/VOCA's long-term advisor, together with other MFI representatives, took part in a collaborative effort of NBKR, USAID, MFIs, President's Administration, and other stakeholders for preparing a draft law to regulate microfinance industry in the country. He was a member of the working group that prepared recommendations on this law.

In August 2002, Law for Microfinance Organizations was passed. The law defines three different kinds of microfinance institutions depending on their legal form and activities carried out:

1. Microfinance companies, established in the form of joint stock companies and carry out microfinance activities using their own funds and borrowed funds - including deposits;
2. Microcredit companies, established in any legal form of commercial organization;
3. Microcredit agencies, established in as non commercial organizations. The law requires microfinance companies to obtain a license and other MFIs to obtain a certificate from NBKR.

Bai Tushum has obtained its National Bank certificate as a Microcredit agency. This new status allows *Bai Tushum* to expense loan loss provisions leading to a significant reduction in taxes it is required to pay, and to lend borrowed funds. However, the tax code needs to be amended before MFIs can benefit from this legislation.

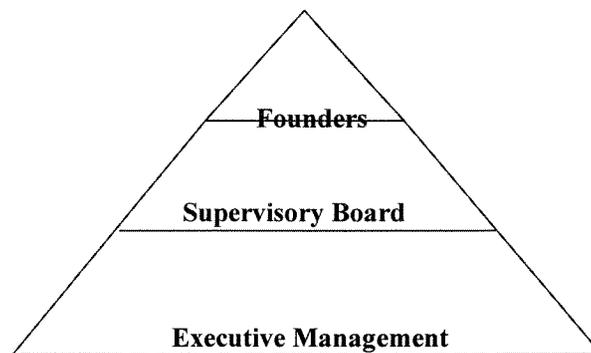
Bai Tushum TA actively participated in the development of the new tax-code to safeguard the interest of *Bai Tushum*. To advocate the MFIs interests effectively, *Bai Tushum* TA participated in several meetings of International Business Council's Committee on Tax Code. *Bai Tushum* also sent a proposal to the Kyrgyz Government working group on Tax-Code, which agreed to incorporate all proposed amendments in the new Tax Code. After the new code is enacted, MFIs will benefit from treating loan losses as deductible expense. Similarly, they will be able to treat the interest paid on commercial loans as deductible expense.

Another challenge stemmed from legal and macroeconomic barriers to lending to poor farmers. In 1997, Kyrgyzstan adopted a "Law on Pledge," requiring full collateralization of all loans. The law was a response to greater capital adequacy requirements for banks and became even more significant in the wake of the Russian economic crisis in 1998. While it is one of the most advanced in the Commonwealth of Independent States, the law carried a number of peculiarities that restrict rural lending. The greatest challenge for rural lenders is that the law only permits finance institutions with a *license* from the National Bank of Kyrgyzstan to accept land as collateral. MFIs in Kyrgyzstan may only receive a *certificate* from the National Bank, and Bank officials use this linguistic nuance to prevent MFIs from collateralizing loans with immovable property. As a result, farmers cannot use their most valuable asset to back loans. *Bai Tushum* TA has presented the MFIs viewpoint on several forums to make the situation more favorable for the microfinance sector.

1.2. Corporate Governance Structure

At the head of the Fund's structure is the Founders' Assembly, formed by representatives of ACDI/VOCA and Caritas. They defined the Fund's mission and objectives and registered it with Ministry of Justice. Soon after the establishment of *Bai Tushum*, Swiss Caritas delegated its authority as Founder to ACDI/VOCA, and consequently ACDI/VOCA has directed and guided the establishment and evolution of *Bai Tushum*. To ensure the long term sustainability of *Bai Tushum*, Technical Advisor proposed and created a high profile Supervisory Board, unprecedented in this part of the world. The Board comprises representatives of ACDI/VOCA and Swiss Development and Cooperative Agency (SDC) as well as distinguished individuals from Kyrgyz business and professional circles. The Founders appoint the members of Supervisory Board on vacant positions, either on the recommendation of the remaining members of the Board or at their own discretion.

The Board members are elected for two years. The Board members elect the chairperson, who should be approved by the Founders. The chair person can be elected for a maximum of two terms of one year each.⁶



Following the international best practices, the *Bai Tushum* Board:

1. approves and ensures compliance with the *Bai Tushum* charter, bylaws, procedures, and other legal requirements;
2. hires competent professionals, establishing clear goals for these executives, closely monitoring their performance, and confronting weaknesses when they surface;
3. sets policy and provides strategic direction to the *Bai Tushum*.

The Board exercises its responsibility by maintaining distance from daily operations; drawing on the institutional memory of the directors; and making binding decisions as a group.

Bai Tushum Board can contain up to seven members. Currently five positions are filled. Janice Stallard, Regional Director of CAMFA chairs the Supervisory Board. A representative of Swiss Caritas, from the Swiss Cooperation office in Kyrgyzstan; a representative of the Kyrgyz NGO sector; and an auditor sit on the Board. Muhammad Junaid, long term Technical Advisor to *Bai Tushum* has been the member of the Board from the very outset.

The board meets quarterly to set policy and approve strategic and business plans and the introduction of new products. The board has held 16 regular meetings in addition to some informal meetings.

During the first meeting of the Supervisory Board held in December 2001, ACDI/VOCA Technical Advisor presented a strategic vision paper that became the basis for the *Bai Tushum* future direction. Subsequently, the Technical Advisor coordinated the regular quarterly meetings. All board discussions and decisions are documented both in English and Russian.

⁶ As an exception the current chairperson can be elected for unlimited number of terms.

BTFB Board is known for its commitment to *Bai Tushum* as well as providing the effective oversight. Recognizing its performance, other MFIs in the region have replicated this model. To learn from *Bai Tushum* experiences, senior managers from Kazakhstan Loan Fund (KLF) and Azerbaijan CredAgro—rural/microfinance institutions established by ACDI/VOCA—visited *Bai Tushum* to attend its Board meetings.

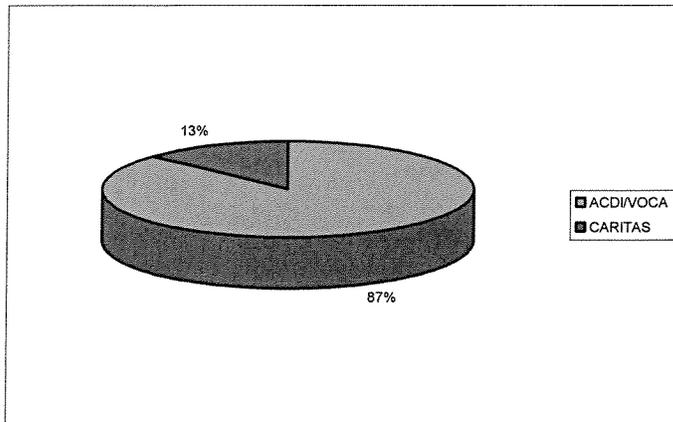
1.3. Donor Support

USAID began funding technical assistance for *Bai Tushum* in its opening years with a cooperative agreement signed in 2001. Additional funding for technical assistance was made available by the Swiss Development and Cooperation Agency (SDC). The USAID Cooperative Agreement No. 116-A-00-01-00027-00 ended on August 31, 2005.

Swiss Development and Cooperation Agency (SDC) contributed towards the compensation of the Technical Advisor and provided loan capital to *Bai Tushum* through Caritas. Other donors include EU TACIS, which has provided funds for the development of a mortgage lending product; and CGAP, which funded a rating exercise conducted by Microfinanza Ltd., a product costing exercise conducted by a local accounting firm, and provided pro-poor innovation grant for providing micro loans to women engaged in dairy industry.

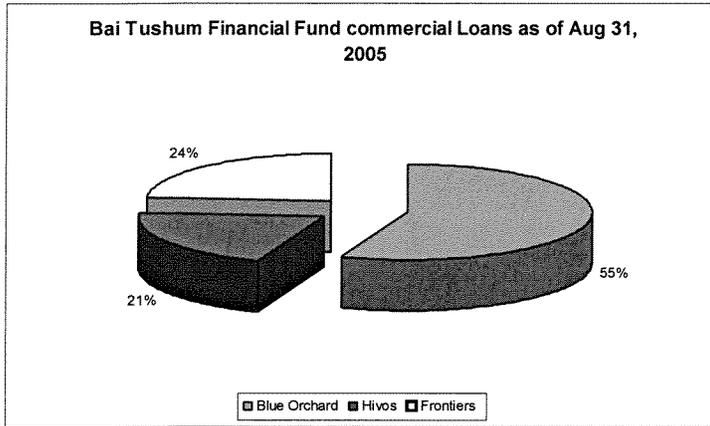
The following table shows the funds contributed by different donors.

BAI TUSHUM FINANCIAL FUND FOUNDERS CONTRIBUTION



Founder	Amount Contributed
ACDI/VOCA (through USDA Monetization Program)	US\$ 2,074,055
Swiss Caritas (donated by SDC)	US\$ 310,354

BAI TUSHUM FINANCIAL FUND COMMERCIAL LOANS



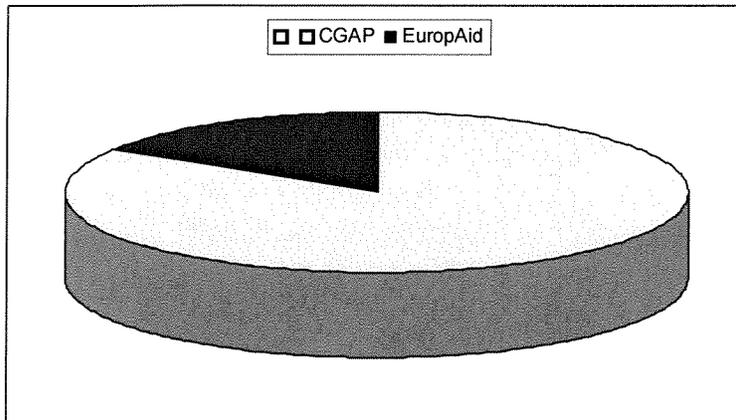
Lender

Dexia Blue Orchard
 Triodos Bank (Hivos Triodos Fund)
 Frontiers

Loan Amount

US\$ 1,000,000
 US\$ 369,000
 US\$ 422,360

**BAI TUSHUM FINANCIAL FUND
 OTHER DONORS**



CGAP
 EuropAid

US\$ 62,000
 US\$ 12,000

To ensure its long term sustainability, *Bai Tushum* has established a strategic alliance with several partners within and outside the country. *Bai Tushum* regularly interacts with these partners and during the past three years the following important alliances were forged:

Consultative Group to Assist the Poor (CGAP): *Bai Tushum* has cooperated with CGAP during the past four years through piloting the best practices and disseminating information. *Bai Tushum* took initiative to become one of the leaders in microfinance industry to conduct a product costing exercise with support from CGAP. *Bai Tushum* also accessed the CGAP grant for conducting international rating exercise. It also won a grant from CGAP/IFAD Rural Pro-Poor Innovation Challenge (RPPIC) through a competitive process, in which more than 500 MFIs participated from around the world. Using this grant, *Bai Tushum* provides loans to women groups to rear milk cows, and lease dairy equipment. In April 2005 *Bai Tushum* received a second grant from CGAP's Rating Fund to cover 60% of the second international rating by Microfinanza. In the summer of 2005 Gulnara Shamshieva, *Bai Tushum's* General Manager received a grant from AMAP to cover her tuition for attending the two-week training at the *Bankakademie* titled "*Leading Change in Microfinance Market*".

Recognizing its extraordinary successes, CGAP has published a case study on *Bai Tushum*, which can be found at http://www.cgap.org/docs/AMCaseStudy_02.html.

Microfinance Center for Eastern Europe and NIS States: *Bai Tushum* management and staff have participated in the various conferences, training courses and other events organized by MFC. MFC has also used *Bai Tushum* as one of its case studies as a successful MFI in the region.

Microcredit Summit: As a member of Microcredit Summit *Bai Tushum* has provided the support to the objectives of Microcredit Summit, including exchange of information and attending the Microcredit Summit conference.

National Bank of Kyrgyz Republic: *Bai Tushum* maintains good working relationships with NBKR. Technical Advisor worked in close cooperation with NBKR during the development of the law on microfinance institutions and subsequently assisted NBKR in developing the normative documents. To share information and provide know-how on the microfinance sector, Technical Advisor arranged several workshops and participated in Board meeting of NBKR as an invited guest.

Government of Kyrgyzstan (GoK) has recognized *Bai Tushum's* contribution to alleviating poverty in Kyrgyzstan. In May 2003, in recognition of their contribution President Askar Akaev awarded the Technical Advisor and two senior *Bai Tushum* managers with presidential awards. Moreover, *Bai Tushum* branches work in close cooperation with the oblast and district governments, without letting them influence *Bai Tushum* internal policies and procedure. *Bai Tushum* enjoys strong support from various levels of the government. *Bai Tushum* has received strong support from the Oblast administration in Osh and Jalalabad. Congenial relationships at the *Rayon* level exist between the government officials and the *Bai Tushum* managers. Demand for MFIs services is increasing because of current unreliable financing. At the municipality level, *Bai Tushum* has many letters of support for expansion from several mayors throughout the country.

Association of MFIs in Kyrgyzstan: In collaboration with other MFIs in Kyrgyzstan, Technical Advisor has also taken initiative to form an association of MFIs in Kyrgyzstan. Initial meetings of a working group have been held, and the association is likely to be formed during the current year. Once established, Association of MFIs will act as an advocacy group for MF sector, disseminate information and education to all the various interested parties.

GTZ: In order to increase its outreach, *Bai Tushum* collaborated with GTZ and some local NGOs to introduce loans to self-help groups as well as rural cooperatives. The new products enable the members of groups and cooperatives to obtain the loans from *Bai Tushum* without pledging any collateral. *Bai Tushum* works with the groups and cooperatives recommended by GTZ to avoid the costs associated with formation, training and retaining group cohesiveness, and to deliver superior quality financial services at lower interest rates.

To implement this loan product, with help from Technical Advisor, *Bai Tushum* developed policies and procedures to appraise, disburse and monitor these loans which includes a simplified version of a business plan. Technical Advisor and *Bai Tushum* senior management conducted training of the *Bai Tushum* loan officers as well as the GTZ project staff. These sessions focused on *Bai Tushum* loan policies and procedures, and the interaction among the various stakeholders.

EU Tacis: EU Tacis awarded a contract to *Bai Tushum* for development of a mortgage lending product in the country. *Bai Tushum* won the bid on the competitive basis that was participated by several banks and financial institutions in the country.

Bai Tushum is a founding member and a member of the Board of Directors of the Credit Bureau in Kyrgyzstan. Sponsored by the EU Tacis, this credit bureau will serve the banking and microfinance sector in the country.



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CA No. 116-A-00-01-00027-00

International Business Council: As a member of IBC *Bai Tushum* regularly participates in all meetings of this lobby group that advocates international investment in local businesses. This forum provides *Bai Tushum* with a platform to promote the interest of microfinance industry and its customers at different forums. *Bai Tushum* was elected as a member of its accounts committee for the year 2004-5.

2. MANAGEMENT

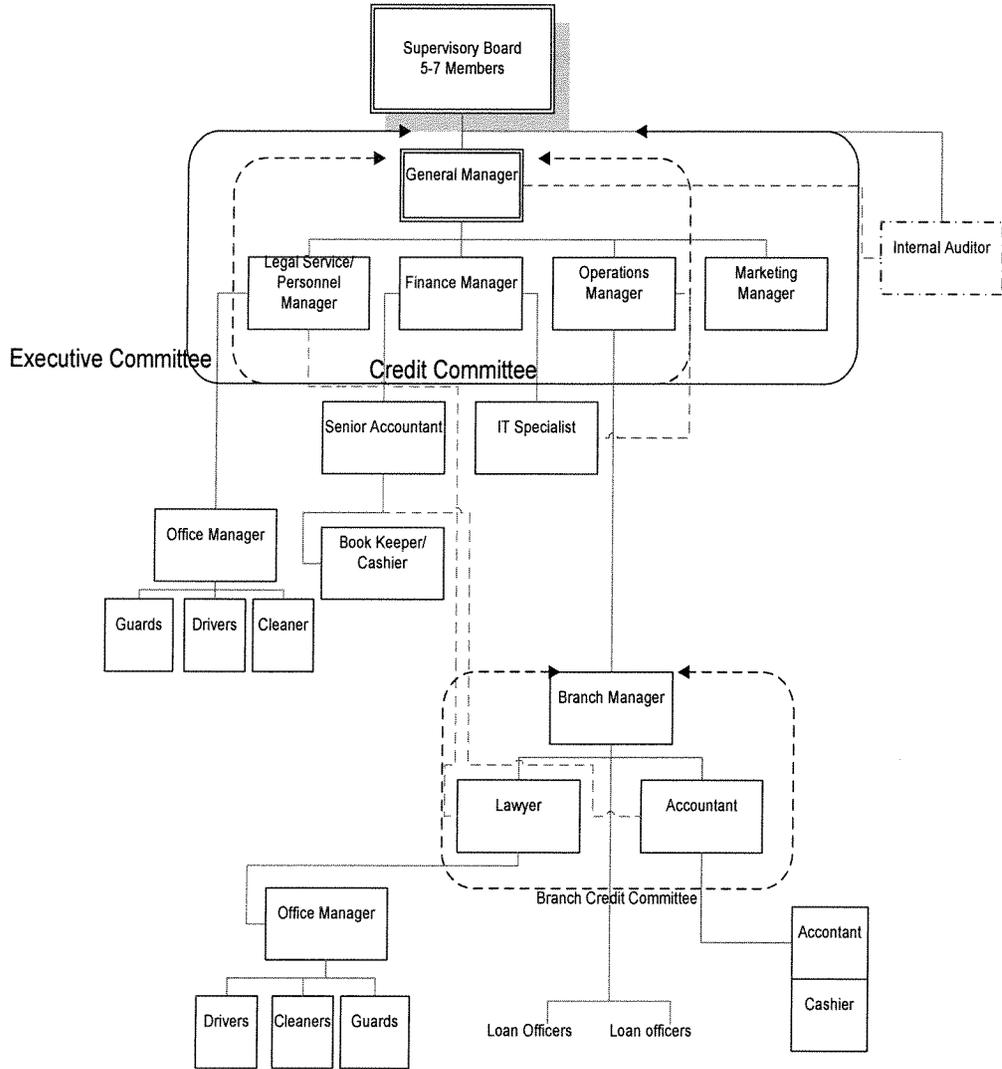
ACDI/VOCA prides itself on creating sustainable microfinance institutions around the world, and for preparing competent local management that can continue with the institution after the donor support is over.

At the start of *Bai Tushum*, the Technical Advisor assumed the role of acting CEO until the management team was put in place. Technical Advisor hired and trained a team of dedicated senior managers capable of managing the institution after the closure of the ACDI/VOCA technical assistance. The management team comprises the General Manager, Finance Manager, Operations Manager, Marketing Manager and the Legal Advisor. Each branch is headed by a Branch Manager. Branch Accountant, Lawyer, loan officers, and support staff report to the Branch managers. The Information Technology (IT) Manager reports to the Finance Manager, and in collaboration with Operations Manager, provides companywide technical support. ACDI/VOCA has also hired and trained an internal auditor, who regularly audits the *Bai Tushum* offices and reports the results and recommendations directly to the Supervisory Board.

The management team is headed by Gulnara Shamshieva, General Manager of the *Bai Tushum*. Through on-the-job-training, Technical Advisor has prepared her to take up the future leadership role. In addition to several microfinance conferences, workshops and seminars worldwide, Ms. Shamshieva has attended an advanced course on management of Microfinance Institutions at the Micro-enterprise Development Institute of Southern New Hampshire University (USA) and a highly prestigious course for senior banking executives at the Bankakademie, Germany.

The following organization chart presents the organization of different functions at HQ, and relationship between HQ and branches⁷.

⁷ The Organization chart shows only one branch to illustrate the HQ/Branch relationship, and typical branch organization. *Bai Tushum* has three branches with varying number of staff.



2.1. Human Resource Management

Like the rest of the country, Bai Tushum's staff has faced dramatic changes in the work place as Kyrgyzstan has moved from a command economy to market economy. Bai Tushum recognizes that building the capacity of the staff, and creating a market-oriented structure, procedures and planning processes that incorporate their participation, are as important to Bai Tushum's success as lending procedures and internal controls. Bai Tushum has developed various incentive systems, including promotion within the organization and cash bonuses. All senior staff members are encouraged to take active part in solving strategic and operational issues. Branch managers join headquarters staff in annual and strategic planning exercises.

Technical Advisor helped *Bai Tushum* develop personnel policies that ensure professional growth of staff at all levels. All operational units are responsible for hiring the staff; though approval must be obtained from the General Manager. HO legal advisor also acts as the Human resource Manager and maintains record for the entire staff. All position openings are filled with the suitable internal candidates before seeking applications from the external candidates. *Bai Tushum* has developed a well articulated personnel policy, which takes into consideration the local legislation, industry standards and international best practices.

2.2. Formal Training

Training staff to approach their responsibilities in a new way was the priority for the Technical Advisor after the establishment of *Bai Tushum*. To meet this challenge, in addition to the training opportunities offered by ACDI/VOCA, USAID and occasionally by other donors, *Bai Tushum* allocates 2% of its annual budget for staff development and training. Every six months, the ACDI/VOCA Technical Advisor conducted an in-house refresher program for the loan officers. In addition, staff members are able to access outside technical training from sources, such as the Microfinance Center in Poland. *Bai Tushum* staff development policy ensures that whenever a key staff member leaves there are internal candidates groomed to take on new responsibilities. In addition, staff members are also able to access outside technical training through links with the Microfinance Center in Poland and other resources.

Bai Tushum has also put in place a strong training program for its newly recruited loan officers. This comprises both formal as well as on-the-job training modules. All new loan officers are hired as trainee officers and they shadow the senior loan officers for on-the-job-training that continues for one year. Once every six months, an in-house refresher training program is conducted by the Foundation's management using a training manual for the loan officers. TA has developed lending staff training manual as well as assisted in developing accounting staff training manual for *Bai Tushum* accountants.

To prevent loan losses and to recover delinquent loans, *Bai Tushum* successfully worked with the Kyrgyz judicial. These successes are related to its strong team of in-house lawyers who oversee the documentation process at all stages of loan disbursement and administration. *Bai Tushum* has put in place a strong training program for *Bai Tushum* lawyers, and a refresher program is conducted twice a year.

Each year Bai Tushum conducts a strategic management workshop, bringing together all senior managers and loan officers from HQ and the branches. This annual event has helped foster a common understanding of the *Bai Tushum* strategy.

An elaborate staff policy manual was developed by the Technical Advisor. This document emphasizes compliance with local laws, transparency in hiring and promoting staff members, non-discrimination, preventing conflict of interest, and rewarding for the better performance.

Bai Tushum has developed and distributed a personnel policies manual relating to staff management issues. All staff members can freely access the manual, which is updated at least twice a year. Each staff person has a job description, a labor contract with *Bai Tushum* and a description of benefits and incentive packages for meeting the expected performance goals.

All senior staff members are encouraged to take an active part in strategic and operational planning of the organization.

Staff levels are determined on the basis of strategic indicators using the “Microfin” model. With increased lending activity and market share of *Bai Tushum*, the staff and administrative cost per loan has sharply decreased. Loan Officers are hired in regular intervals based on the portfolio growth projections and staff turnover.

2.3. Loan Officer Profile

Thanks to stringent recruiting and training standards, *Bai Tushum* Loan officers are considered to be among the best in Kyrgyzstan. Since very few MFIs can match these training standards, *Bai Tushum* prefers to hire and train its staff. All new credit officers have a trial period of three months, during which they do not manage their personal credit portfolio and they receive reduced compensation.

Bai Tushum usually hires outstanding recent university graduates majoring in finance, banking, accounting and agriculture. These graduates usually have good understanding of the local business environment and development issues. Some of them come with banking experience and from other MFIs, but nevertheless go through *Bai Tushum*'s training program. In addition to technical issues, the new recruits receive extensive training on marketing, and customer service. The loan officers usually serve for a year as interns before elevated to the loan officer's position. In the past banking industry was dominated by the male loan officers. *Bai Tushum* has been systematically changing this trend to give women more representation in the industry. Currently, most of management staff as well as loan officers are women.

2.4. Staff Compensation System

Bai Tushum has devised a system of compensation that encourages higher performance at all levels. The staff receives a basic salary, which is complemented by a generous performance bonus. Salaries are determined in line with the private sector standards, based on the employees' qualifications, skills, performance, marketability and salary history.

An incentive policy is in-place for which a share of the salary of the loan officers depends on the performance of their portfolio. The bonus policy is based on portfolio quality indicators. The bonus is calculated and paid each quarter. *Bai Tushum* has also introduced a bonus system for the administrative staff. Bonuses are paid twice a year and depend on financial results of the branches and of the whole institution such as operational self-sufficiency, repayment rate, and portfolio-at-risk.

The incentive system is based on transparent criteria to encourage the build up of a high quality diverse loan portfolio, to increase loan repayment, to increase the Foundation's income and to reduce loan losses. Upon achievement of certain quality benchmarks, the loan officer receives a percentage of the loan disbursement and repayments as incentive. For example, a loan officer with 100 loans and 98% repayment rate may receive a bonus equal to two months salary.

Administrative staff may receive a bonus once every six months depending on financial results. The amount of bonus for each operational unit is determined by that unit's financial sustainability.

Bai Tushum staff can also receive a consumer loan at a concessionary interest rate. This loan is available to staff members that at least complete one year of service with *Bai Tushum*.

The incentive system enables the staff to earn a salary that is usually higher than that of their counterparts in the banking and microfinance institutions.

2.5. Turnover

After experiencing a high turnover in the initial years, *Bai Tushum* developed a core team of dedicated professionals. Because of zero tolerance for inefficiency and corruption, the contracts for the staff members not meeting the highest performance criteria are not renewed. Since the other employers are aware of the excellent training standards, some of our staff members have left to take top positions in other organizations.

The following statistical summary shows the staff compensation and turnover during the past three years. It demonstrates that percentage of loan officers and line staff has steadily improved during the life of the project. It should be noted that increased emoluments are only one aspect of improved benefit package for the staff members. The staff has recognized better training opportunities as an incentive to serve with *Bai Tushum*.

Bai Tushum's reputation as the market leader in providing training to its staff has tremendously increased the marketability of staff. Consequently, some of *Bai Tushum* managers and loan officers left the organization to join the competition. In other cases, some staff members did not fulfill the stringent quality standards and were asked to leave. *Bai Tushum* staff policy is geared toward retaining the high quality staff.

Bai Tushum Financial Fund

Human resources statistical summary

	Dec 01	Dec 02	Dec 03	Dec 04	Aug 05
Number of total staff , end of period	41	48	52	70	83
Average staff (for computation only)	40	51	58	66	76
Number of staff hired during period	33	4	10	40	28
Number of staff who left during period	11	3	6	23	9
Turnover rate (staff who left over avg. number of staff) ⁸	28%	6%	10%	3%	9%
Number of loan officers , end of period	8	12	14	19	27
Percent loan officers of total staff	20%	25%	27%	25%	26%
Number of administrative staff , end of period	8	15	16	25	26
Number of line staff , end of period	33	33	36	26	30
Average annual loan officer compensation in current US\$	\$ 1,408	\$ 1,524	\$ 2,291	\$ 2,450	\$ 2,553
Typical annual compensation for veteran loan officers	\$ 1,903	\$ 2,408	\$ 2,515	\$ 3,667	\$ 3,401
Avg. loan officer compensation as multiple of per capita GDP	4.51	4.78	6.10	11.15	9.44

⁸ The main contributors to the staff turnover are support staff such as guards, drivers and cleaners.

Avg. loan officer compensation as multiple of avg. outstanding balance per loan	0.83	0.65	1.54	2.00	1.85
Staff training expenditures as a % of annual administrative budget (excluding financial and loan-loss costs)	1%	1%	1%	1%	4%

3. FINANCIAL MANAGEMENT

Bai Tushum has created strong accounting and financial management systems to ensure proper accounting, reporting and analysis. It has been using operational and strategic plans since its inception and regularly reviews its capacity and growth strategies.

During the project life the Technical Advisor facilitated a strategic and operational planning process using Microfin—a sophisticated Microsoft Excel spreadsheet model, designed to assist Microfinance Institutions in developing detailed financial projections to accompany their business plans. *Bai Tushum* has also developed an elaborate system for preserving the lending capital of the Fund. It uses liquidity management tool for monitoring liquidity, and a budget monitoring tool for tracking the budget performance.

The *Bai Tushum* financial team now comprises of experienced and highly qualified staff members. This team regularly conducts an analysis of the Fund's entire financial activity including financial report analysis (balance sheet, income statement, cash flow, budget analysis, and portfolio quality and trend analysis) using CGAP performance indicators. Financial and other reports that are used in institutional assessment represent a comprehensive and precise picture of institutional performance needed for its assessment at any stage of development.

On a monthly basis *Bai Tushum* evaluates its assets and portfolio quality according to the norms set by the National Bank of Kyrgyz Republic for commercial banks and creates loan loss reserves. The Fund has developed a policy for the write offs the actual condition of the loan portfolio. The Board uses data of such analysis in the process of managerial decision-making and the quality control of assets.

To expand its products and services, *Bai Tushum* took foreign currency denominated loans from the international investors.⁹ To hedge against foreign currency risk, *Bai Tushum* has obtained a credit line in local currency from a local bank, which substantially mitigates the exchange risk, lowers the financial cost, and increases profitability of the institution.

During the lifetime of the project the TA held the co-signing authority with the General Manager on use of Founders' contributions to expand *Bai Tushum's* loan portfolio. This provided a supervision mechanism against any loan losses or misuse of loan funds. Now that there are other effective controls available, signing authority will be delegated to the General Manager and the Finance Manager of the Fund.

3.1. Loan Loss Provision and Write-Off

Bai Tushum adjusts the loan loss reserve on a monthly basis according to the classification of the active loans based on their risk of default. Loans are classified on the basis of different aspects, qualitative and quantitative, like legal quality of collateral, legal status of the borrowers, sector orientation, availability and types of loan guarantees, reliability of guarantors, assessment of borrower's fulfillment of previous obligations, borrower's economic perspectives, etc. The MIS

⁹ As on 31 July 2004, *Bai Tushum* has commercial loans amounting to US\$300,000 from Dexia Blue Orchard, and 300,000 Euros from Triodos Bank.

automatically proposes a classification for each loan which is approved by the branch credit committee. Loan portfolio is divided into two parts – classified and non-classified. Accordingly, reserves for potential negative profits and losses are divided into specific and general reserves. The following chart shows the system of asset classification, and resulting provision of loan loss reserve.

Classification	Main Indicators	% of reserve
Non - classified		
A-satisfactory loans (Borrowers in good financial condition and with a high solvency)	Loan principal repayments are made on time Loan interests overdue up to 10 days Value of collateral exceeds value of loan, collateral is highly liquid	2%
B-loans under observation (Borrowers in good financial conditions but some aspects of the financial state are doubtful)	Loan principal repayments are made on time Loan interest overdue up to 30 days Value of collateral exceeds value of loan, but evident deterioration in collateral liquidity is observed	5%
Classified		
C-sub-standard loans (Borrowers with some shortcomings in their financial state, borrowers which are unable to meet <i>Bai Tushum</i> requirements)	Loan principal overdue up to 30 days Loan interests overdue up to 90 days	25%
D-bad loans (Borrowers in weak financial condition, their losses are currently growing)	Loan principal overdue from 31 to 180 days Loan term was prolonged Value of collateral is decreasing, its quality is deteriorating, its liquidity is doubtful and the collateral is hard to sell at the originally appraised value.	50%
E-loan losses (Borrowers unable to pay the loan)	Loan principal overdue is more than 180 days Loan term was prolonged more than once	100%

3.2. Diversification of Assets

Bai Tushum has adopted the policy of asset diversification to ensure long-term sustainability of the institution. To take advantage of the lower real estate prices in the market, *Bai Tushum* purchased the office premises for Osh and Chui branches as well as the head office in Bishkek. These buildings are centrally located, and market value of these premises has already improved in the market. *Bai Tushum* already owned the Jalalabad branch building which was transferred to it by Swiss Caritas, one of the *Bai Tushum* Founders. This policy has resulted in substantial reduction of occupancy expenses, improvement of corporate image and increase in the asset value.

3.3. Policies, Procedures and Internal Controls

Bai Tushum has adopted a decentralized system of loan approval, disbursement, and monitoring. This has resulted in reducing the transaction time and cost for loan approval and disbursement, and enhancing the service standards. However, the decentralized systems require a higher degree of supervision and strong internal controls to protect the institution and to reduce losses. *Bai Tushum* has developed a stringent internal controls system whereby all financial transactions in *Bai Tushum* pass through a series of routine checks. An Internal Control Manual has been developed and introduced throughout the organization. All financial documents must bear two signatures, and revolving loan funds of the Foundation are jointly operated by the ACDI/VOCA Technical Advisor and the General Manager of the Foundation.

Bai Tushum has zero-tolerance policy for corrupt practices. To ensure compliance with this policy, *Bai Tushum* has adopted a policy of internal checks and balances. The branches have credit committee system, to avoid corrupt practices in loan disbursement. All loans are approved by the branch credit committees; though the loan officer is present at these meetings, he or she is not a part of the decision making.

With help from Technical Advisor, *Bai Tushum* has developed a wide range of policies and procedures, which have been approved by the Supervisory Board. Policies and procedures manuals cover almost all operational areas and are the “living documents” subject to continuous review. Some of the important BTFF’s policies and procedures are listed in Exhibit A1 of Annex 1.

3.4. External Audit and Evaluation

To maintain transparency and quality of financial and management controls, the Foundation decided to have the internal controls and annual accounts audited by an outside reputable bank auditing firm. The auditors submitted their past three audit reports to the *Bai Tushum* Supervisory Board.

International Rating: To further its plans to access commercial funding from international investors, *Bai Tushum* obtained a positive “A” rating in 2002 and “A+” rating in 2005 from Microfinanza, Ltd.¹⁰ The rating report of 2002 noted a number of challenges and achievements. Significant among the challenges were increased competition, particularly for small and micro enterprise loans, by institutions offering loans at lower interest rates. External and internal factors contributed to this situation. The largest competitor – (KAFC) had a history of lending at subsidized rates of interest. At the same time, *Bai Tushum*’s limited scale, lack of operating subsidy, and relatively low case load for loan officers all drove up its costs per loan. However, operating efficiency was improving with increases in portfolio size and quality. The evaluation also encouraged an increased diversification in the loan portfolio, and a related shortening of the average loan term.¹¹

Strengths noted in the assessment included comprehensive and formal procedures and internal controls, rapid and efficient loan disbursements, tight management of costs; positive financial results, a solid governance structure, and good training policies.

Microfianza assigns “A” rating to those MFIs that have demonstrated “Strong capacity to meet its financial obligation; very good operations; stable even if it could be affected by major internal or external events” Translated into numbers an “A” rating is measured at 8 on a scale of 1-10. Microfianza has summarized their assessment about the *Bai Tushum* Operation as under:

“*Bai Tushum* has developed a solid organizational structure with a well designed system of governance, a complete formalization of procedures, a good internal control and a complete MIS. The financial performance has been improving during the years till a positive AROE, the operational costs are low and diversification between rural and urban portfolio is improving. Financial sources are made only by equity with no leverage and no maturity and foreign currency gap...”

The 2005 Microfinanza rating showed significant improvements in *Bai Tushum* operations over the 2002 baseline rating. The summary of the rating is provided below:

¹⁰ “Microfinanza” is an internationally renowned Italian evaluation and rating firm, which specializes in providing assessment of performance standards of microfinance institutions around the world using CGAP and IDB disclosure guidelines.

¹¹ Since the evaluation, and as a result of other best practice initiatives, *Bai Tushum* has introduced a wide range of new loan products and increased the loan officers’ case-load.

AREA	Changes and comments	Trend
<p>External environment and market positioning</p>	<p>Important changes in the political situation with a potential instability at least until the next election later this year</p> <p>Increasing competition, especially in the urban areas. A variety of actors, including, MFIs, commercial banks and non financial banking institutions, are targeting the microfinance market.</p> <p>BTFF registered in 2003 under the new law on microfinance as a microcredit agency. Nevertheless some benefits of the registration of BTFF under the new law on microfinance have not still materialized (for example the possibility to treat provisions as a cost).</p>	<p>Negative</p>
<p>Governance, management and operations</p>	<p>The ACDI VOCA Long Term Adviser left BTFF on September 2004, a sign of the progressive independence of the institution from ACDI/VOCA.</p> <p>Management is better structured and the organization chart has been improved. Anyway an human resources manager is still missing.</p> <p>The bonus system for Loan Officers has been improved several times and it is now well functioning. Management and back office staff salaries remain lower than the market, increasing the risk of defection of the trained employees. Staff turnover is high.</p>	<p>Slightly Positive</p>
<p>Financial products and assets quality</p>	<p>Portfolio diversification has substantially increased: agricultural loans (41%) are now well balanced by urban SME loans (51%), with the remaining part represented by housing loans and other products (8%).</p> <p>The group lending methodology has been introduced since 2003. As of March 2005, group lending represents 3,6% on total outstanding portfolio, and 17% of total active clients.</p> <p>The diversification of repayments schedule has not substantially changed.</p> <p>Housing and consumer loans have been introduced, increasing product diversification.</p> <p>Interest rates have been substantially reduced in 2004, because of growing competition.</p> <p>Portfolio quality has notably improved (PAR 30 2,3% and write off ratio 1,6%).</p>	<p>Positive</p>
<p>Financial structure and ALM</p>	<p>BTFF has started to access to external borrowing in 2003 and it has shown a positive capacity to attract lenders, both national and internationals.</p> <p>The debt/equity ratio increased from 0,0 as of October 2002 up to 0,4 as of March 2005.</p> <p>The Foundation has no significant currency gap, interest gap and term gap.</p> <p>The equity increased by 60% between October 2002 and March 2005 with a strong growth in the share of retained earnings (as of March 2005 they represents 38% of the equity).</p>	<p>Positive</p>
<p>Financial and operating results</p>	<p>Profitability and sustainability, both adjusted and not adjusted, increased compared to October 2002.</p> <p>Operational efficiency has increased while the costs related to external borrowing augmented due to the access to commercial loans.</p> <p>Productivity in terms of number of borrowers has not changed substantially and it is still not satisfactory even if it is increased in terms of amounts.</p> <p>In spite of a strong reduction of interest rates in 2004 that lowered the portfolio yield of about 10 percentage points, BTFF has managed to maintain its ROE constant in the last two years.</p>	<p>Positive</p>
<p>Strategic objectives and future evolutions</p>	<p>BTFF is planning to become a microfinance company in 2006, a commercial entity that can collect savings.</p> <p>A new business plan 2005-2009 has been developed and approved.</p>	<p>Stable</p>

Strengths: <ul style="list-style-type: none"> ➤ Strong organizational structure ➤ Good portfolio quality ➤ Full financial sustainability and satisfactory profitability ➤ Low operational costs ➤ Qualified staff 	Opportunities: <ul style="list-style-type: none"> ➤ Transformation in a commercial entity ➤ Improve the functioning of the credit bureau ➤ Potential market especially outside of the main towns
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Final opinion

BTFF has been able during the last years to maintain a good pace of growth, to strengthen its organizational and management structure and to considerably increase the quality of its portfolio. Moreover it is operational and financial self-sufficient since 2002, with an high level of efficiency, and it has reached a good profitability. It has shown the capacity to access to external commercial borrowing and it is planning to become a commercial entity. Nevertheless there remain still some deficiencies in the human resources ratio with an high staff turnover, the clients drop-out is sensibly high and the productivity is limited. Moreover there are some risks related to the MIS, to the planned transformation in a microfinance company and to the present and future positioning compared to the competition. The instability of the political situation of the country is an important external factor of risk.

AREA	Changes and comments	Trend
External environment and market positioning	<p>Important changes in the political situation with a potential instability at least until the next election later this year</p> <p>Increasing competition, especially in the urban areas. A variety of actors, including, MFIs, commercial banks and non financial banking institutions, are targeting the microfinance market.</p> <p>BTFF registered in 2003 under the new law on microfinance as a microcredit agency. Nevertheless some benefits of the registration of BTFF under the new law on microfinance have not still materialized (for example the possibility to treat provisions as a cost).</p>	Negative
Governance, management and operations	<p>The ACDI VOCA Long Term Adviser left BTFF on September 2004, a sign of the progressive independence of the institution from ACDI/VOCA.</p> <p>Management is better structured and the organization chart has been improved. Anyway an human resources manager is still missing.</p> <p>The bonus system for Loan Officers has been improved several times and it is now well functioning. Management and back office staff salaries remain lower than the market, increasing the risk of defection of the trained employees. Staff turnover is high.</p>	Slightly Positive
Financial products and assets quality	<p>Portfolio diversification has substantially increased: agricultural loans (41%) are now well balanced by urban SME loans (51%), with the remaining part represented by housing loans and other products (8%).</p> <p>The group lending methodology has been introduced since 2003. As of March 2005, group lending represents 3,6% on total outstanding portfolio, and 17% of total active clients.</p> <p>The diversification of repayments schedule has not substantially changed.</p> <p>Housing and consumer loans have been introduced, increasing product diversification.</p> <p>Interest rates have been substantially reduced in 2004, because of growing competition.</p> <p>Portfolio quality has notably improved (PAR 30 2,3% and write off ratio 1,6%).</p>	Positive
Financial structure and ALM	<p>BTFF has started to access to external borrowing in 2003 and it has shown a positive capacity to attract lenders, both national and internationals.</p> <p>The debt/equity ratio increased from 0,0 as of October 2002 up to 0,4 as of March 2005.</p> <p>The Foundation has no significant currency gap, interest gap and term gap.</p> <p>The equity increased by 60% between October 2002 and March 2005 with a strong growth in the share of retained earnings (as of March 2005 they represents 38% of the equity).</p>	Positive
Financial and operating results	<p>Profitability and sustainability, both adjusted and not adjusted, increased compared to October 2002.</p> <p>Operational efficiency has increased while the costs related to external borrowing augmented due to the access to commercial loans.</p> <p>Productivity in terms of number of borrowers has not changed substantially and it is still not satisfactory even if it is increased in terms of amounts.</p> <p>In spite of a strong reduction of interest rates in 2004 that lowered the portfolio yield of about 10 percentage points, BTFF has managed to maintain its ROE constant in the last two years.</p>	Positive
Strategic objectives and future evolutions	<p>BTFF is planning to become a microfinance company in 2006, a commercial entity that can collect savings.</p> <p>A new business plan 2005-2009 has been developed and approved.</p>	Stable

3.5. Management Information Systems (MIS)

One of the largest hurdles that *Bai Tushum* faced after the merger of its independent credit programs was inadequate MIS for the three branches. The consolidation of all program data required technical assistance on a day-to-day basis, and monitoring of the various performance indicators was difficult at the central level. Since September 2001, *Bai Tushum* began developing an MIS that could standardize the collection and processing of information across the *Bai Tushum* branches. This MIS included a loan tracking system and an accounting system. Both systems were integrated.

Bai Tushum developed an in-house management information system that managed and tracked financial and loan information on a real time basis. The system originally comprised of two separate programs for Financial Accounting and Loan Tracking, producing up-to-the-minute reports down to the branch level, and consolidating daily activities of the Foundation at the end of each day. The reports provided an immediate assessment of the performance of staff members and operating units and permitted timely assessment of each loan. All loan officers received MIS reports for repayment in arrears. The MIS was tested for accuracy by internal and external auditors as well as the raters. *Bai Tushum* also developed and distributed a comprehensive user manual.

The accounting software was built following internationally accepted accounting standards, guidelines from the Kyrgyz National Bank, and standards prescribed by CGAP and SEEP. The *Bai Tushum* continued to modify the system to produce requested reports, as needed.

The MIS served *Bai Tushum* well during the first three years. Technical Advisor, however, recommended that, in view of the steady growth in its portfolio and increasing competition in the market, a new enterprise MIS needs to be introduced to meet the growing information needs. In late 2004 BTFF, with support from ACDI/VOCA, conducted a market research to identify the most suitable MIS system. In February 2005 it was decided that the best option would be to procure the additional and updated modules of the presently used MIS. These five modules included accounting, loan tracking, payroll, fixed assets and savings. The new version of the MIS has been installed and can be used by the future deposit-taking Microfinance Company.

4. CUSTOMERS AND PRODUCTS

Bai Tushum's analysis of the predecessor credit associations' operations revealed problems with the organizations' almost exclusive concentration on agricultural lending. In addition to the risk of widespread defaults due to weather conditions and market fluctuations, as well as marked seasonal expansions and contractions associated with agricultural lending, administering loans to rural farmers was expensive. Given Kyrgyzstan's sparse population, loan officers regularly traveled 200 km to monitor loans. The combination of high administration costs and unpredictable repayment rates led to a net loss for the associations. An activity based costing exercise conducted with financial assistance from CGAP found that for each *som* lent for crop production; the associations had an average return of only 0.94 *som*. Losses arose from the high costs of monitoring crop production loans, and high delinquency rates in the sector.

A close review of the associations' outstanding loans also exposed an unexpected trend. Farmers had been borrowing for agricultural production – the credit associations' sole loan product – but were using these loans to fund other business activities. Borrowers' misappropriation of loan proceeds meant that the associations were incorrectly pricing their products. Trade loans could command higher interest rates than agriculture and were less risky. The credit associations had thus foregone a valuable opportunity.

Bai Tushum's first step toward sustainability was shifting from providing only high cost agricultural loans to creating products that served a range of rural borrowers' needs. When *Bai Tushum* polled its clients on the type of products they needed, small and medium enterprise (SME) loans topped the list. SME loans were equally valuable to *Bai Tushum* because they allowed the institution to attain greater

economies of scale – loan officers could serve a cluster of urban or rural borrowers on their way to visit agricultural clients. The first new products offered were agro-processing and trade loans. In 2003, the organization also branched into mortgage lending. At the end of 2000, 95% of the new institution's portfolio was concentrated in crop production and livestock loans. By the end of 2003, those loans represented 50% of the portfolio. *Bai Tushum* has been careful to maintain the absolute volume of agricultural portfolio while diversifying into other loan products.

During the four years of its operations, *Bai Tushum* has established itself as a market leader in introducing diverse range of loan products. In keeping with its mission to develop both the rural and urban sectors of the country, *Bai Tushum* offers the following loan products to farmers and entrepreneurs:

- **Crop Production Loans** – e.g., for the purchase of seeds and grain;
- **Livestock Loans** – e.g., for dairy production; cattle, pig and sheep breeding; poultry and fish farming; honey production;
- **Small and Medium Enterprise (Agro processing) loans** – e.g., for agricultural processing, manufacturing and packaging;
- **Small and Medium Enterprise (Trade & Services) loans** – e.g., for financing restaurants, automobile services and tourist businesses;
- **Housing Finance** – for the acquisition of fixed assets for residential and business purposes;
- **Equipment Finance:** for acquisition of plant, machinery, agricultural implements and vehicles;
- **Consumer loans** - to its valued clients, *Bai Tushum* provides loans for acquiring household items as well as financing the children's educational expenses;
- **Solidarity Group loans** – To promote self employment among rural women who do not have collateral to access credit resources, *Bai Tushum* developed a group-based loan product using CGAP/IFAD grant. This enabled rural women to buy milk cows, process and sell milk products. The project was implemented in collaboration with Rural Consultative Services, a local NGO. This pilot project showed high demand and success rate, and *Bai Tushum* replicated this model to finance other types of businesses as well.
- **Loans to Trade and Service Cooperatives** - under an MOU with GTZ, *Bai Tushum* provides loans to agricultural cooperatives formed and fully trained by GTZ, mainly in Osh and Jalalabad oblasts. An average loan size is 500 U.S. dollars per borrower. Loans are provided to each member of the group for the period of 18 months at 20% p.a. As of August 31, 2005, 10,822,700 som (\$263,968) were disbursed to 87 groups (648 persons). These loans account for 5% of the total loan portfolio. Although extremely popular, this product is very risky as the loans are issued without a pledge of collateral. Therefore, *Bai Tushum* requested that USAID allow using 500,000 U.S. dollar DCA guarantee to support group lending to small businesses in rural areas. These two last products are priority direction for *Bai Tushum* as it strives to reach out to the least served rural poor, especially in the light of increasing competition from a number of banks and non-banking financial institutions.

All loans are disbursed and repaid in local currency, in cash or through bank transfer. Interest rates are fixed, but may be revised by mutual agreement of the borrower and lender. Interest is paid monthly or quarterly and penalties are charged in cases of late interest or principal repayment. The Fund does not provide repeat loans to customers with multiple delinquencies. Loans are not provided for financing existing debts, starting new business, speculative businesses, growing or processing tobacco, the production or sale of liquor, or other businesses or projects with negative environmental or social impacts.

Bai Tushum uses conservative, market oriented, and competitive portfolio management and pricing policies. Principal loan repayments and the founders' cash contributions are used for the revolving loan fund. The founders or donors do not subsidize operational expenses. The *Bai Tushum* meets its operational costs through interest income. The entire earned income is directed to covering all expenses; net earnings are re-invested into lending capital.

All of these loans range in size from 10,000 to 1,000,000 soms (\$230-\$23,000 dollars), with an average loan balance of \$1,580. All individual loans are backed by collateral, and the borrowers are

required to have a 25% equity stake in the financed activity. Equity can be contributed in form of cash, labor or in-kind contributions. Most of *Bai Tushum*'s crop, livestock and enterprise loans carry terms of 12 to 18 months, while mortgages are extended for up to five years. By engaging in strict financial discipline and capitalizing on economies of scale, *Bai Tushum* has also been able to meet another frequent borrower request: lower interest rates.

In early 2004, the organization was able to maintain profitability while significantly decreasing its nominal interest rates for first time borrowers – from 36% down to 26% for crop production, livestock and agro-processing loans, and 24% for housing finance. Interest is charged on declining balance basis, and there is no penalty for early loan repayment. Current interest rates are among the lowest in the Kyrgyz market for such type of borrowers. Lower interest rates also improved *Bai Tushum*'s ability to compete with its largest direct competitor, the Kyrgyz Agricultural Finance Corporation (KAFC), a quasi-governmental rural lender that provides subsidized loans to its borrowers.

The following table shows the portfolio breakdown:

	DEC 01	DEC 02	DEC 03	DEC 04	AUG 05
Crop Production Loans					
Number of active loans at end of period	209	333	282	447	907
Percentage of clients who are women	15%	14%	15%	22%	31%
Average balance per loan (\$US)	1,416	1,377	1,276	1,133	909
Average balance/per capita GDP	5	4	3	3	3
Livestock Loans					
Number of active loans at end of period	248	356	514	748	788
Percentage of clients who are women	13%	13%	25%	32%	29%
Average balance per loan (\$US)	1,654	1,588	1,331	1,342	1,637
Average balance/per capita GDP	5	5	4	4	5
SME Loans					
Number of active loans at end of period	231	277	560	775	897
Percentage of clients who are women	40%	24%	54%	49%	47%
Average balance per loan (\$US)	1,928	2,512	1,621	2,240	2,788
Average balance/per capita GDP	6	8	4	7	8
Staff Consumer Loans					
Number of active loans at end of period	12	14	14	29	29
Percentage of clients who are women	50%	59%	74%	48%	45%
Average balance per loan (\$US)	1,788	2,593	3,372	2,335	2,113
Average balance/per capita GDP	6	8	9	10	6
Clients Consumer Loans					
Number of active loans at end of period			4	22	19
Percentage of clients who are women			25%	32%	21%
Average balance per loan (\$US)			1,411	1,696	1,422
Average balance/per capita GDP			4	5	4
Mortgage					
Number of active loans at end of period		-	34	47	100

Percentage of women clients		0%	36%	55%	48%
Average balance per loan (\$US)		-	3,192	3,181	3,734
Average balance/per capita GDP		-	9	10	11
TOTAL					
Number of active loans at end of period	700	980	1,408	2,068	2,740
Percentage of women clients	26%	32%	36%	37%	36%
Average balance per loan (\$US)	1,693	1,792	1,492	1,693	1,864
Average balance/per capita GDP	5	6	4	5	6

4.1. Proposed Product: Loans to Community Drinking Water Users Unions (CDWUUs)

In the southern region of Kyrgyzstan (Osh, Jalalabad and Batken oblasts), drinking water supply is scarce and unreliable. To help the rural communities find sustainable solutions in drinking water supply, the Asian Development Bank has provided a loan to the Kyrgyz Republic for establishing and developing CDWUUs.

At that time, there were 325 CDWUUs registered in three southern oblasts of Kyrgyzstan. Only 67 of them had projects for creating and rehabilitating water supply systems, and part of these projects were partially financed by ADB. According to the financing scheme, CDWUUs were required to contribute 5% in cash for implementing the project. Most communities were unable to provide this contribution. Bai Tushum proposed a loan product to fill this gap in collaboration with the USAID/DCA. Bai Tushum's plan was to provide loans to CDWUUs to finance 1) working capital; 2) procurement of machinery and equipment; 3) infrastructure maintenance; and 4) other commercial uses related to the project.

DCA offered to cover 50% of the principal amount of loan through a guarantee facility of \$500,000. The remaining risk was to be covered through marketable collateral provided by CDWUUs.

The Fund developed special procedures on CDWUU's loan borrowings. Those procedures contained criteria for CDWUUs selection, instructions on working with the loan, and step-by-step diagnostics of CDWUUs. The training seminars with participation of CAMFA specialists were organized for branch managers, lawyers, and credit specialists. Several meetings and seminars were organized with the ADB project management, government officials at the national and oblast levels and CDWUU Associations to explain the purpose of the project and teach the CDWUU how to work with the product. Seminars for CDWUU members were organized by the Fund with assistance from the AED/START USAID/CAR Participant Training. Despite all of these activities, CDWUU have not applied for a single loan. The reason for that is the CDWUU's lack of collateral and the people's expectation that the government will pay for their water. At the same time, every rural administration has huge debts for electricity and outstanding liabilities for taxes and payments to the social fund.

4.2. Product Costing

Using a CGAP grant *Bai Tushum* conducted a costing exercise to determine the real costs for each individual loan product in each of its branches. This exercise was very productive, and its results positively impacted the future profitability of the *Bai Tushum*. As a result of this exercise, the management of the *Bai Tushum* fine-tuned the prices on various loan products and revised its strategic plan to strategically position itself in the local market. *Bai Tushum* used both conventional as well as Activity Based Costing (ABC) method for computing the costs associated with each product. *Bai Tushum* was the first MFI in Central Asia to conduct this exercise.

4.3. Impact - Creation of Employment

Bai Tushum, through its lending programs has been able to create a large number of employment opportunities in the rural areas, particularly in the southern region of Kyrgyzstan. It is estimated that for every US\$250 invested in lending capital ACDI/VOCA and *Bai Tushum* have provided (or helped maintain) employment to one person.

In addition to creating permanent employment (in many cases for the young men and women of the family), these SMEs and farm enterprises also provide seasonal employment to a large number of people in planting, harvesting, and marketing seasons. For example it is estimated that in Osh oblast an average farm enterprise funded by the *Bai Tushum* provides a seasonal employment to about 12 people during harvesting of cotton.

5.0 . Bai Tushum SWOT Analysis:

Strengths	Weaknesses
<ul style="list-style-type: none"> • Unparalleled corporate governance structure in the microfinance industry in central Asia, with supervisory board comprising of dedicated board members. • Well articulated vision and mission statements that envisage a sustainable microfinance institution operating on free-market principles. • Qualified and experienced management team and loan officers. • Well planned strategic direction and existence of documented strategic plan. • Extensive market research leading to a diverse range of loan products meeting the needs of different customers. Lending in agricultural and rural sectors as well as pro poor loan products. • Regular financial and market analysis, product costing, internal and external audits. These analyses help Bai Tushum price its products realistically and competitively. • Most Bai Tushum products have a flexible product design and adequate loan repayment period matching the clients' cash flow. • Excellent in-house training system and access to outside professional training. • Comprehensive staff compensation and motivation package. • Comprehensive policies, procedures and internal controls covering all operational, accounting and administrative areas. • Donor and investor trust for Bai Tushum, and access to international and local commercial funding. • Operational and financial self-sufficiency and sustainability. Low cost of operations. Higher return on equity. 	<ul style="list-style-type: none"> • The current legal structure of Bai Tushum is limiting for its growth. The law does not permit to pay dividends on equity, and the investors are reticent to invest in “non-commercial” organizations. The current legal structure does not give any tax advantages. • Excessive dependence on real estate as collateral. Inability to accept land as collateral • Limited number of branches leading to smaller coverage of geographic areas. Operations are confined to four oblasts of Kyrgyzstan. • Need for more training on information technology to the staff based in remote branches. • MIS technology becoming obsolete, and needs replacement. • Limited availability of commercial funding to finance the lending operations. • K AFC provides long term finance for animal breeding, which Bai Tushum cannot because of its liquidity structure.

<ul style="list-style-type: none"> • Transparency of operations. Internal and external audits, ratings, newsletters and annual reports. Most financial and operational information is available on the internet. • Pleasant working environment for staff. Comfortable workspace and access to the latest information technology available in Kyrgyzstan, and central location of all its offices. • Well developed management information system meeting the most information needs. • Excellent financial and risk management system, adherence to internal accounting and reporting standards, and proactive approach to adopt the international best practices. • Bai Tushum pays all its taxes, and there are no legal grey areas in its operations and management. • Good cooperation with various government and regulatory agencies, NGOs, private sector and donor funded business development business development centers. 	
<p>Opportunities:</p> <ul style="list-style-type: none"> • A strong Bai Tushum would lead to an extended provision of the rural finance services in Kyrgyzstan, especially in the geographic areas it does not currently operate. • Bai Tushum has developed a diverse range of loan products, and drawing on its past experience and staff expertise, it could be on the forefront of developing new loan products in the Kyrgyz market. This would open the doors for the other MFIs to innovate and serve the rural and urban micro entrepreneurs. • With its strong and transparent operations, internal controls, financial management and well trained and qualified staff, Bai Tushum has been recognized by many donors' investors as a success story. With its good external rating, Bai Tushum has attracted external commercial investment, and is in a position to further leverage its equity with loans from foreign and local financial institutions. • Bai Tushum has enormous opportunities for future growth, by acquiring or 	<p>Threats</p> <ul style="list-style-type: none"> • Political and macroeconomic instability in Kyrgyzstan can pose a threat to all MFIs including Bai Tushum. The impending presidential elections might ignite the political unrest and require a cautious approach. • Though presently under control, inflation and local currency devaluation in future can wipeout the equity base of Bai Tushum. Bai Tushum embarked on a policy of managing that risk by hedging its foreign currency borrowing through a local commercial bank. • Oversupply of microfinance services in the recent past has caused a tough competition in the industry. Bai Tushum has responded positively to this competition by fine-tuning the existing products and introducing the new ones. However, unregulated supply of subsidized funding may jeopardize the sustainability of many MFIs. Cheap credit supply by the subsidized MFIs might cause a customer out-flow from the Bai Tushum. • Bai Tushum currently depends on the foreign investors for expanding its

<p>absorbing smaller MFIs into its folds. It also has the capacity</p> <ul style="list-style-type: none"> • to function as a technical powerhouse for the microfinance industry in the region. Its membership of numerous professional networks has given a respectable place in the professional community. 	<p>operations. A change in the lending policy of those lenders may cause a potential threat for the Bai Tushum.</p> <ul style="list-style-type: none"> • A major drought or natural calamity may lead to a whole sale default of loans thus wiping out much of its lending capital. • After the departure of expatriate members of Supervisory Board, the management may under pressure from unscrupulous government officials.
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Through long and short-term technical assistance, ACDI/VOCA has helped *Bai Tushum* become operationally and financially sustainable institution. The next two major milestones for *Bai Tushum* will be to:

1. Expand client base through an increased loan portfolio, expand into new geographical areas, and introduce new loan products;
2. Increase access to commercial finance from the local and international markets.

Through a guided strategic planning process, *Bai Tushum* has set forth the following clear strategies for growth over the next few years:

- Avoid targeted subsidized loans, and invest in profitable, liquid loan portfolio.
- Encourage a flexible, competitive pricing structure based on Activity Based Costing, and analyze the pricing policy on continual basis.
- Continually work to improve the existing loan products and introduce new products to promote SMEs, attract better borrowers and build a superior quality portfolio.
- Look for diverse geographic markets to avoid concentration of excessive credit supply in any one geographical region.
- Work with donors, financial regulators and other stakeholders to explore the feasibility of introducing other financial services and increase outreach.
- Further improve the financial reporting and monitoring system to evaluate accessibility, efficiency and sustainability.
- Increase retention rates for repeat clients.
- Improve quality of staff and client training.
- Reach the number of more than 4,000 clients as of 5th projected year end.

ANNEX 1

A1. List of Bai Tushum's Guiding Documents

1. **Charter of the Foundation:** Is a founding document that regulates the order of the Foundation's activity. The Charter determines: organizational and legal form of the Foundation, its name, location, manager's authorities, management and control bodies and their competencies, etc.
2. **Organizational Structure of the Fund:** approved by the Supervisory Board. It includes management, executive bodies, structural units and departments and administrative subordination of these bodies. Organization charts of Foundation Head Office and Divisions.
3. **Bylaws of Branch Offices:** approved by the Supervisory Board. this document determines the order of activity, authorities of the Division, authorities of the Branch Manager in charge of the Division and relations with Head Office.
4. **Credit Manual:** approved by decision of the Supervisory Board. Credit Manual contains principal provisions on issues of the Foundation's lending policy, customer eligibility, policy of analysis and loan portfolio classification, creation of loan loss reserve, principal issues of loan management, responsibilities and authorities of Foundation Departments that participate in credit provision process, internal control for loan disbursement and loan repayment procedures etc.
5. **Lending criteria for crop production:** This document determines lending criteria, target clientele, purposes for which a loan may be provided, main terms of credit provision, list of documents to be submitted by customers.
6. **Lending criteria for livestock production and meat and milk production:** This document determines lending criteria, target clientele, purposes for which a loan may be provided, main terms of credit provision, list of documents to be submitted by customers.
7. **Lending criteria for small and medium scale businesses (industry):** This document determines lending criteria, target clientele, purposes for which a loan may be provided, main terms of credit provision, list of documents to be submitted by customers.
8. **Lending criteria for small and medium scale businesses (trade):** This document determines lending criteria, target clientele, purposes for which a loan may be provided, main terms of credit provision, list of documents to be submitted by customers.
9. **Regulations on consumer loans to employees of Bai Tushum Financial Foundation:** The Regulations determine procedures and terms of consumer loan provision to employees of the BTFF.
10. **Regulations on loan classification and deductions to loan loss reserve:** These Regulations determine the order and frequency of loan portfolio classification, including:
 - Division of loans into classifiable and non-classifiable depending on loan default risk;
 - Description of factors for classifying loans to the categories;
 - Size of deductions to loan loss reserve;
 - Appraisal of portfolio quality, etc.
11. **Regulations on Credit Committee of the Foundation:** The document covers tasks, functions and authorities of Credit Committee and organization of its activity and determines loan approval authorities (depending on loan value).

- 12. Regulations on Internal Audit Department of BTFF:** The Regulations determine Internal Audit Department's role in the Foundation structure and regulates its main goals and functions, obligations and responsibility.
- 13. Personnel Policy and internal work order regulations:** This document regulates the internal order, issues related to personnel, employment, dismissal and payments to the employees.
- 14. Accounting policy and procedures**
- 14.1 Chart of Accounts:** Description of accounts applied by the Foundation.
- 14.2 Instruction on operating accounts in Foundation Branches:** The Instruction determines the order of opening and operating accounts by Foundation Branches, balance limit on operational account and petty-cash.
- 14.3 Procedures of procurement, receipt of donated by outside organizations, transfer and write off for capital assets:** This Procedure describes transactions related to procurement, receipt of donated by outside organizations and accounting of capital assets of the Foundation, and also write off for capital assets.
- 14.4 Procedure for subsequent accounting of expenses for capital assets maintenance**
The Procedure gives definition of subsequent expenses, determines accounting order for subsequent expenses that increase efficiency of capital assets usage.
- 14.5 Procedure for depreciation accrual on capital assets, reassessment and inventory**
The procedure determines depreciation accrual order, its reflection in accounting and off-system accounting of depreciation accruals for tax purposes.
- 14.6 Regulations on off-system accounting:** The Regulations describe the order for transactions accounting that do not bear risk for the Foundation. For example, written off loans, interests and penalties are accounted off-system.
- 14.7 Regulations on creation of loan loss reserve:** Determine the order for creating loan loss reserve, its sources, calculation methodology and sizes of deductions to loan provision reserve.
- 14.8 Procedure for creation of loan loss reserve:** The Procedure determines the order of creation and accounting of loan loss reserve.
- 14.9 Regulations on order of issuance and accounting of advances to the employees:**
The Regulations describe the order of issuance, accounting of advances to the employees by the Accounting Department and terms for submitting reports on their utilization.
- 14.10 Loan Accounting Policy of Bai Tushum Financial Foundation:** The document determines the Foundation policy for accounting transactions with disbursed loans. In particular, it determines separation of responsibilities between the Loan Officers that disbursed the loans and the officers that control loan repayment, loan classification, accounting and etc. There are general provisions on creation of loan loss reserve, loan restructuring, and transfer of collateral into ownership and application of interest non-accrual status to loans.
- 14.11 Policy for accrual of interests and penalties on overdue interest and principal repayments:** The Policy determines methodology and order of interest accrual for loans provided by the Foundation, and order and terms for penalty accrual on overdue interest and principal repayments.
- 14.12 Policy for accounting Items of Nominal Value and other tangible assets in Bai Tushum Financial Foundation:** The document determines the Foundation policy for accounting items

of nominal value. The policy describes the order of procurement, accounting and write off for items of nominal value, its inventory and reassessment.

15. **Regulations on business travels:** The Regulations determine the order of sending employees to business trips and norms of refunding business trip costs.
16. **Regulations on cash risks of BTFF:** The Regulations determine the order of receipt, issuance, storage and transportation of cash and valuables for security purposes. It outlines procedures and responsibility of executive officers in case of violation of this order.
17. **Documentation Classifier of BTFF:** The documentation classifier is a systemized list of documents issued by the Foundation and Branches that specifies storage term formalized in due order. Documentation classifier is developed with the purpose to reasonably distribute documents, create files, search and account for documents.
18. **Instruction on collateral management:** The Instruction provides recommendations on managing collateral property, including preferential types of collateral, order of collateral appraisal, legal expertise of collateral documents, repossession of pledged property and transfer of property into the Foundation ownership as repayment of loan debt.
19. **Procedure for losses write off:** The Procedure outlines terms for classifying loan as a loss, order of consideration and decision-making by Supervisory Committee for loans write off, reflection of accounting transactions for write off on balance accounts and order for follow-up activity with losses.
20. **Procedure for consumer loan provision to Bai Tushum employees**
The document describes procedures for consideration of loan applications, conclusion of loan and collateral (mortgage) agreements, issuance and accounting of loans, order of interest and principal amount repayment.
21. **Regulations on bonus payments to employees of the Foundation** The Regulations determine criteria of bonus payments to different categories of Foundation employees; frequency of performance evaluation for bonus payment purposes, order for calculating bonuses, sizes and terms of bonus payments.
22. **Draft Policy on Asset and Liability Management Committee, Draft Policy on Assets and Liability Management, Draft Policy for Risk Management** will be presented to the Supervisory Board for approval in October 2005.
23. **Job descriptions of:**
 - Chairperson of Executive Board approved by decision of the Supervisory Committee as of July 2, 2001;
 - Internal Auditor approved by decision of the Supervisory Committee as of July 2, 2001;
 - Branch Manager approved by Chairperson of Executive Board on April 30, 2001;
 - Credit Coordinator approved by Chairperson of Executive Board on August 1, 2001;
 - Chief Accountant approved by Chairperson of Executive Board on November 20, 2000;
 - Legal Adviser approved by Chairperson of Executive Board on January 03, 2002;
 - PR Specialist approved by Chairperson of Executive Board on July 3, 2001;
 - Secretary/Personnel Officer approved by Chairperson of Executive Board on July 1, 2001;
 - MIS Specialist approved by Chairperson of Executive Board on August 1, 2001;
 - Branch Accountant approved by Chairperson of Executive Board on April 30, 2001;
 - Cashier approved by Chairperson of Executive Board on May 10, 2001;
 - Branch Legal Adviser approved by Chairperson of Executive Board on May 3, 2001;
 - Loan Officer approved by Chairperson of Executive Board on April 5, 2001;
 - Financial Analyst approved by Chairperson of Executive Board on April 30, 2001.

A2. Financial Statements

As of August 31, 2005			
		As of Aug 31, 2005 Local Currency	As of Aug 31, 2005 USD
US\$	Current Exchange Rate:		40,9603
	ASSETS		
B1	Cash and Bank Current Accounts	8 106 626	\$ 197 914
B2	Short-Term Investments/Interest bearing deposits	56 721 210	\$ 1 384 785
B3	Gross Loans Outstanding	209 440 542	\$ 5 113 257
B4	(Loan Loss Reserve)	(7 524 416)	\$ (183 700)
B5	Net Loans Outstanding	201 916 126	\$ 4 929 557
B6	Other Current Assets	14 835 949	\$ 362 203
B7	Total Current Assets	281 579 911	\$ 6 874 459
B8	Long-Term Investments		
B9	Fixed Assets: Property and Equipment Costs	20 499 064	\$ 500 462
B10	(Accumulated Depreciation)	(4 591 183)	\$ (112 089)
B11	Net Property and Equipment/Net Fixed Assets	15 907 881	\$ 388 373
B12	Total Long-Term Assets	15 907 881	\$ 388 373
B13	TOTAL ASSETS	297 487 792	\$ 7 262 832
	LIABILITIES AND NET WORTH		
	LIABILITIES		
B14	Client Savings and Time Deposits		
B15	Other Deposits	0	
B16	Short-term Borrowings (Commercial Rate)	108 656 300	2 652 722
B17	Total Current Liabilities	108 656 300	2 652 722
B18	Long-term Debt (Commercial Rate)		
B19	Long-term Debt (Concessional Rate)	15 137 700	369 570
B20	Other Liabilities	8 025 785	\$ 195 941
B21	TOTAL LIABILITIES	131 819 785	\$ 3 218 233
	NET WORTH/EQUITY		
B21	Paid-In Equity (Shareholders)	95 810 678	\$ 2 339 111
B22	Donated Equity (Loan Fund)	1 640 360	\$ 40 048
B23	Donated Equity (Cumulative Grants for Operations)		
B24	Retained Net Profit/(Loss) - Prior Years	53 266 110	\$ 1 300 433
B25	Net Profit/(Loss) - Current Period	14 950 861	\$ 365 009
B27	Total Net Worth/Equity	165 668 008	\$ 4 044 599
B28	TOTAL LIABILITIES AND NET WORTH	297 487 792	\$ 7 262 832

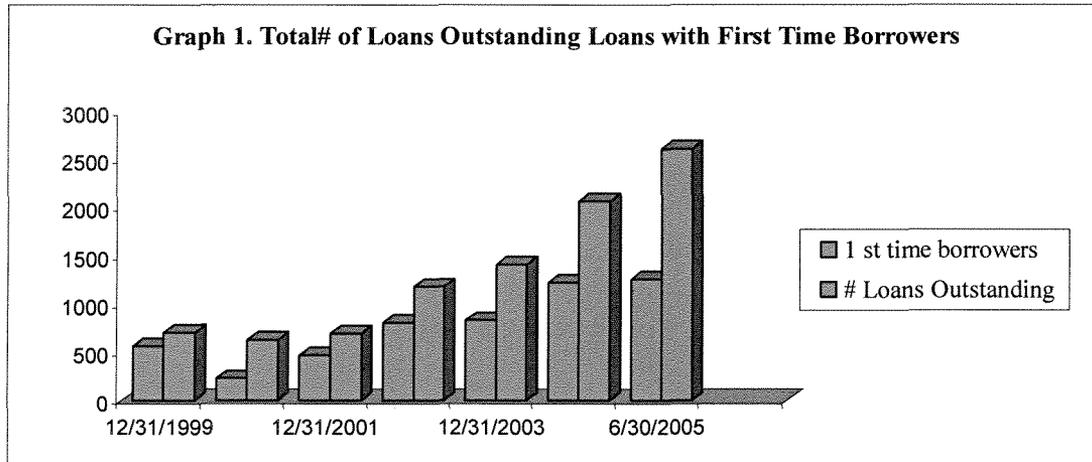
Income Statement		FOR THE PERIOD ENDING August 31, 2005	
		Local currency	USD
US\$	Current Exchange Rate:	40,9603	
	FINANCIAL INCOME		
I1	Interest on Loans	29 278 940	\$ 714 813
I2	Interest on Investments	2 787 364	\$ 68 050
I3	Loan Fees	4 108 727	\$ 100 310
I4	Total Financial Income	36 175 030	\$ 883 173
	FINANCIAL EXPENSES		
I5	Interest on Debt	4 424 035	\$ 108 008
I6	Interest Paid on Deposits		
I7	Total Financial Costs	4 424 035	\$ 108 008
I8	Gross Financial Margin	31 750 995	\$ 775 165
I9	(Provision for loan losses)	(1 125 830)	\$ (27 486)
I10	Net Financial Margin	30 625 165	\$ 747 679
	OPERATING EXPENSES		
I11	Salary and Benefit Expenses	7 621 214	\$ 186 063
I12	Administrative Expenses	3 186 773	\$ 77 802
I13	Other Expenses	4 866 317	\$ 118 806
	Taxes	0	\$ -
I14	Total Operating Expenses	15 674 304	\$ 382 671
I15	Net Income from Operations	14 950 861	\$ 365 009
I16	Donations/Grants for Operating Exp.		
I17	Net Profit/(Loss) - Current Period	14 950 861	\$ 365 009
I18	Donations/Grants for Loan Capital	1 640 360	\$ 40 048
I19	Net Income- Profit/Loss	16 591 220	\$ 405 056

A3. Portfolio Analyses

Graph 1

Bai Tushum Financial Fund

Total # of Loans Outstanding and Loans to First Time Borrowers



	12/31/1999	12/31/2000	12/31/2001	12/31/2002	12/31/2003	12/31/2004	6/30/2005
1 st time borrowers	563	234	473	807	833	1226	1261
# Loans Outstanding	708	633	700	1182	1408	2068	2615

The number of total loans outstanding increased in the first 6 months of 2005 by 26% when compared with December 2004, which is a positive indication of BTFB lending activity growth.

**Micro-credit Agency
“Bai Tushum Financial Fund”**

**Transformation Strategy:
becoming a regulated deposit-taking financial organization**

2005 - 2008

**Prepared by:
MFA “Bai Tushum Financial Fund”**

**With assistance from:
ACDI/VOCA
Under USAID Cooperative Agreement
116-A-00-01-00027**

August, 2005

I. Introduction

Bai-Tushum Financial Fund (“BTFF”), a non-profit public fund, was established on October 24, 2000 by ACDI/VOCA and CARITAS under a USAID-funded program with the main objective to improve social and economic development of rural and urban areas in the Kyrgyz Republic through lending to individuals, small businesses and farms that have no access to the formal banking sector and technical assistance. In July 2002, the Law on Microfinance Organizations in the Kyrgyz Republic (“MFI Law”) was adopted which introduced three types of microfinance organizations that were allowed to operate under the supervision of the National Bank of Kyrgyzstan (“NBK”):

- (i) micro-finance company (MFC), a first-tier deposit-taking non-banking financial organization, which can be formed only as joint stock company (JSC);
- (ii) micro-credit company (MCC)- a second-tier non-banking credit organization, which can be formed as for-profit commercial legal entity (no restrictions on the type of for-profit entity);
- (iii) micro-credit agency (MCA) – a third-tier non-banking credit organization which could operate as a non-profit legal entity.

Shortly thereafter, BTFF, being a non-profit public fund, was re-registered with the Ministry of Justice of the Kyrgyz Republic and registered with the NBK as Micro-credit Agency implementing its micro lending activities on the basis of NBK certificate.

Since its inception BTFF has achieved positive results with portfolio growth in both 2003 and 2004 of approximately 58% annually (for more information on BTFF historic financial performance, please refer to Annex 1). Currently BTFF has an outstanding loan portfolio of 4 million USD. BTFF has a solid management team and well developed credit administration and internal management policies and procedures. In addition, BTFF’s corporate governance structure is well developed.

BTFF is currently facing limitations to its expansion due to its current non-profit nature. In particular, BTFF has found that potential lenders and investors are reluctant to provide loans and/or equity funding due to BTFF’s unclear ownership structure. In addition, as a non-profit micro-finance agency, BTFF is restricted to lending activity only and is not permitted to take deposits as well as engage in other types of banking operations when compared to MCC- and MFC-type microfinance institutions. Being able to take deposits is considered a key strategy for BTFF over the next five years. Deposits are a cheaper source of financing for lending operations and also provide an additional service to clients, which can assist with client increase and retention.

Hence, BTFF in consultations with ACDI/VOCA decided that in order to successfully implement its expansion plans, it needs to transform into a for-profit legal entity with a goal to meet all regulatory requirements for obtaining a deposit-taking license from the NBK. With assistance from ACDI/VOCA’s staff and transformation consultant, John McNulty, and VERITAS Law Firm, BTFF researched various options to achieve that goal. The following has been determined as the optimal strategy for achieving BTFF’s transformation objectives:

Stage One: BTFF shall establish a wholly owned Limited Liability Company - the Microcredit Company “Bai-Tushum and Partners” LLC -- January 2006.

Stage Two: Convert the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”, into a Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners” - October – November 2007.

Stage Three: Transform the Closed Joint-Stock Company Microcredit Company “Bai-Tushum and Partners”, into a Closed Joint-Stock Company, the Microfinance Company “Bai-Tushum and Partners” - January 2008.

The following sections describe the regulatory requirements, legal and financial aspects of the transformation process that BTFF will go through in the next 3 years.

II. Benefits of a staged approach

Having conducted an in-depth analysis of the current regulatory regime, within the limits of which a micro finance company can be formed, BTFF team recognized that outright creation of a new closed joint stock company and securing of an MFC license will not be feasible for the following reasons:

1. According to the Law “On micro finance organizations in the Kyrgyz Republic” the founders – local legal entities – of micro finance companies are only allowed to have a share in the capital of no more than 20%, i.e. currently BTFF does not have an opportunity to be a sole founder of micro finance company and possess majority of shares, which is considered to be important for preserving the social mission of the fund;
2. Outside investors intend to have shares in the capital of micro finance company in the amount of 15-20% of stated chartered capital – i.e., to form a JSC, at least four additional international investors would be needed;
3. The minimum amount of charter capital of micro finance deposit-taking company must be 25 (twenty-five) million KGS. Charter capital of micro finance company can be formed only in cash, which is a burdensome requirement as most of BTFF’s financial resources are utilized for lending. Unless BTFF starts accumulating cash resources, which would impair its ability to provide services to its clients to its full capacity, meeting the minimum charter capital requirement is not feasible;
4. Temporary Rules “On regulating activities of micro finance companies on the territory of the Kyrgyz Republic” prescribe specific regulative requirements for microfinance companies, which are more stringent than those prescribed for micro-credit companies;
5. On a specified stage, the ability to attract additional resources to Micro Finance Company will be restricted by capital adequacy requirement. Under minimal chartered capital requirement of 25 million KGS (0.6 million USD), the maximum amount of attracted resources would add up to 2.8 million USD. At the same time, the capital adequacy ratio will be equal to 18% (maximum amount allowable);
6. National bank instructions on defining capital adequacy standards for commercial banks allow commercial banks to include subordinated debt into equity capital when calculating capital adequacy ratio. Whereas, Temporary Rules of micro finance companies regulation do not allow microfinance companies to include subordinated

debt into equity capital. Under minimal capital of 25 000 000 KGS, the maximum amount of attracted resources can not exceed 114 800 000 KGS. This amount was taken into consideration in the immediate-5-year strategic plan of MCA BTFF;

7. Finally, registering and managing a closed joint stock company is rather complex and expensive from a regulatory compliance standpoint when compared to a limited liability company.

Given such regulatory restrictions and since deposit-taking license cannot be obtained until two years after the formation of a commercial entity, it was determined that there is no need to form JSC right away and that forming a limited liability company/obtaining an MCC-type license has certain advantages:

1. In accordance with Law "On Microfinance organizations in the Kyrgyz Republic" and Temporary Provision of National bank of Kyrgyz Republic "On Establishing Micro Credit Companies and Micro Credit Agencies", Micro Credit Company can be established in any legal form of commercial structure.
2. There is no ownership restrictions that apply to LLC/MCC-type legal entities – i.e., BTFF can create such wholly owned subsidiary on its own without the need to attract additional investors.
3. Minimum charter capital requirements for LLC are much smaller and BTFF will have no problem meeting them;
4. Less complex incorporation and licensing procedure;
5. For the next close to two years while operating as MCC, regulatory compliance will be less burdensome and expensive;
6. Procedure for sale/transfer of interest in LLC is more simple when compared to JSC in terms of registering such transaction with local authorities;
7. Transferring stock in an LLC can only be done with approval of other owners – this could be a benefit given that BTFF would have a say in any sale of ownership stake in the Company by outside investors.

After two years of operating as MCC, the company will then convert into a closed JSC.

III. Transformation Stages

BTFF retained legal services of Veritas Law Firm to provide advice on legal aspects of the transformation. Veritas opinion, dated August 18, 2005, attached hereto as Annex 2, contains detailed description of the legal process for setting up a limited liability company, obtaining NBK's certificate to operate as MCC, transferring of assets from BTFF to the newly created company, and further conversion of LLC into CJSC/MFC.

1st stage (January 2006) BTFF will register in a form of limited liability company (hereinafter referred to as LLC) and apply for a certificate of "Micro Credit Company". In this case, MCA BTFF can be the sole founder of Micro Credit Company. Charter of the Micro Credit Company "Bai Tushum & Partners" LLC has been already prepared with the assistance of the Veritas Law Firm (please refer to Annex 3).

Chartered capital of Micro Credit Company can be formed only with cash assets. For governmental registration of Micro Credit Company as a legal entity, it is required to pay in cash the minimal chartered capital in the amount of 100 000 KGS. At the time of registration the Fund will be able to pay a substantially larger amount. The amount of stated charter capital will

be set at the amount equal to disbursed loans which are expected to be paid back to BTFF within a year after the date of registration. Having received loans back, the cash assets will be transferred, as contributions, to the chartered capital of Micro Credit Company in several tranches.

As a result of complete payment of stated chartered capital in December 2006 – January 2007, and because of subsequent need to increase chartered capital, re-registration of Micro Credit Company must be completed. If decision to transfer entire capital of MCA BTFF will be made, several re-registrations with the Justice institutions might be needed.

Changes in MCA BTFF, connected to the establishment of micro credit company “Bai-Tushum & Partners” LLC:

1. Establishment of MCC “Bai Tushum & Partners” LLC does not imply liquidation of BTFF. Both of indicated organizations will exist and develop simultaneously. However, MCC “Bai Tushum & Partners” LLC will have a broader range of services and a higher level of potential compared to BTFF;
2. On the other hand, BTFF has abundant experience, good reputation in the micro finance market and, what is very important, “Bai-Tushum” Fund employs well-educated and highly professional staff;
3. Personnel of BTFF will be transferred to Micro Credit Company “Bai-Tushum and Partners” (employees might be “laid off” on the basis of transfer). Labor contract conditions in Micro Credit Company should NOT deteriorate compared to those of BTFF;
4. Several branches of the newly created company will be established in provinces. Personnel of the BTFF’s branches will be transferred to the branches of MCA “Bai Tushum & Partners” LLC. However, the branches of BTFF will not be liquidated until entire loan portfolio will be completely turned over to new commercial structure;
5. Organizational structure of BTFF after establishment of MCC “Bai Tushum & Partners” LLC will be as follows: General Assembly of the Founders, Supervisory Board and single Executive body. Appropriate amendments to the Charter of BTFF will be proposed;
6. The number of Supervisory Board members of BTFF might decrease to three or five;
7. A portion of Fund’s loan portfolio will be assigned to MCC “Bai Tushum & Partners” LLC under contract of agency;
8. An Executive Director and Accountant will be appointed in BTFF. They will maintain records of Fund’s investments into MCC “Bai Tushum & Partners” LLC and income from loan portfolio;
9. Fixed assets of BTFF might be leased to MCC “Bai Tushum & Partners” LLC;
10. The main source of income for BTFF will be dividends from investments and rental payments income from leased property; in addition, BTFF will continue to solicit grant funding to conduct charitable activities;
11. BTFF’s debt liabilities will be assigned to MCC “Bai Tushum & Partners” LLC.
12. MCC “Bai Tushum & Partners” LLC will have the same social mission:

“To contribute to the sustainable development of Kyrgyz economy for the prosperity of society and improvement of the living standards through provision of financial, technical and consulting assistance to small and medium-size enterprises”.

In the second half of 2007 the following activities are planned:

1. Active marketing research;

2. Development of deposit products;
3. Introduction of new Management Information System;
4. Training of personnel to work with deposits.

October - November 2007:

Transformation of MCC “Bai Tushum & Partners” LLC into a CJSC. At this time (October – November 2007) the composition of founders (prospective shareholders of the future Micro Finance Company) must be formed. Shareholding in the CJSC will be driven by the regulatory requirements. If no amendments to the current MFI Law are made to waive the 20% ownership restriction for local legal entities, BTFF will plan on transferring a certain portion of its shares to ACDI/VOCA, a founder of BTFF, so as to maintain collective majority shareholding position in the CJSC.

The following activities are planned during the third stage:

- 1) BTFF, personnel and ACDI/VOCA will be three of the five potential founders of Micro Finance Company;
- 2) The main condition – when establishing Micro Finance Company, the Mission (approved by all Founders) of the company must be included in the Constituent Agreement. This Mission should NOT contradict to the Mission of MCA BTFF;
- 3) General Assembly of the Founders should create an organization group (Executive Board of Micro Credit Company “Bai-Tushum”), which will develop a draft of Charter, organizational structure, working schedule, business plan, and entire package of documents necessary for registration with the Ministry of Justice and National bank of the Kyrgyz Republic;
- 4) Prospective capital structure:
 - BTFF¹ – 20%;
 - ACDI/VOCA – 35%;
 - Personnel of Micro Credit Company “Bai-Tushum” – 5%;
 - International Finance Corporation – 15%;
 - European Bank for Reconstruction and Development – 15%;
 - CASEAF (HIVOS) – 10%.

December 2007:

To co-ordinate the re-registration into micro finance closed joint-stock company issue with National bank and Ministry of Justice. Receiving a license from National bank is planned.

January – March 2008:

Start of micro finance company’s activities. Launch a deposit collection scheme.

IV. Operational Plan of Transformation

¹ Provided that no amendments related to the restrictions for local legal entities will be moved into the Law “On Micro Finance Organizations”. Otherwise, the share would have to be transferred to ACDI/VOCA, so that ACDI/VOCA, MCA BTFF would collectively own the majority of shares in prospective Micro Finance Company.

#	ACTION	DATE	IN CHARGE	OUTCOME
1.	Implementing a legal examination of plan and transformation concept	July 31 st , 2005	General Manager - Shamshieva G.J.; Legal Advisor – Shafeeva G.G.	Plan and concept of transformation for Supervisory Board's review and approval
2.	Review and approval of the transformation plan by Supervisory Board	August 9 th , 2005	Executive and Supervisory Boards	Approved transformation plan
3.	Developing drafts of constituent documents for limited liability Micro Credit Company. Development of Charter and organizational structure	August 2005	“Veritas” law firm and Executive Board	Drafts of constituent agreement, Charter and preliminary organizational structure
4.	Review and approval of constituent agreements, Charter and organizational structure	October 2005	Executive and Supervisory Boards	Approved Charter
5.	Accumulation of cash assets required to pay in stated chartered capital of Micro Credit Company (1 st registration – 1 million KGS)	September – October 2005	Executive Board and Chief Accountant	Transfer of cash assets and inception of lending activities
6.	Registration of Micro Credit Company “Bai-Tushum and Partners”	November 2005	Executive Board and branch managers	Receiving of legal entity certificate. Registration with National bank
7.	Transfer of staff from MCA BTFF to Micro Credit Company. Recruiting of new personnel into micro credit company and MCA BTFF	November – December 2005	Executive Board	Human resource is available to micro credit company
8.	Application of policies and procedures of MCA BTFF to Micro Credit Company	October 2005	Executive Board. Requires approval of Micro Credit Company's Board of Directors	Approved policies and procedures
9.	Re-registration as a result of increased stated capital of Micro Credit Company (2 nd registration)	December 2006 - January 2007	Executive Board, Chief Accountant	Continuation of loan disbursements by

				Micro Credit Company
10.	Conducting marketing research on new product – deposits. Development of new product. Training personnel. Preparation of computer information system	July – December 2007	Executive Board	All set to introduce a new product starting in 2008
11.	Transfer of share in equity to ACDI/VOCA and personnel	October – November 2007	Executive Board	N/A
12.	Sale of share in equity to other investors (IFC, CASEAF, HIVOS, EBRD)	October – November 2007	Executive Board	Capital infusion
13.	Transformation of limited liability Micro Credit Company into closed joint-stock Micro Finance Company	November – December 2007	Executive Board	Registration of closed joint-stock Micro Credit Company
14.	Preparation for transformation of Closed Joint-stock Micro Credit Company into Micro Finance Closed Joint-stock Company. Development of Constituent Agreement draft: <ul style="list-style-type: none"> • Development of Charter’s draft and preliminary organizational structure; • Holding a meeting of the General Assembly of Founders; • Approval of organizational structure; • Appointing new members of the Board of Directors 	October 2007	Executive Board	Submission for consideration of Micro Credit Company’s Board of Directors
15.	Registration of Micro Finance Company in the Ministry of Justice and National bank of the Kyrgyz Republic. Submission of the application for license	December 2007 – January 2008	Executive Board	Registration in the Ministry of Justice and receiving a license from National bank
16.	Registration of Micro Finance Company’s branches	January 2008	Executive Board	Opening of branches

**ANNEX 1
BTFF'S HISTORIC FINANCIAL STATEMENTS**

Balance Sheet, as of June 30, 2005

	US\$ Current Exchange Rate:	40.9614	
B1	Cash and Bank Current Accounts	4,905,493	\$119,759
B2	Short Term Investments/Interest Bearing Deposits	40,104,508	\$979,081
B3	Gross Loans Outstanding	193,225,711	\$4,717,263
B4	(Loan Loss Reserve)	(7,549,385)	(\$184,305)
B5	Net Loans Outstanding	185,676,326	\$4,532,958
B6	Other Current Assets	14,910,640	\$364,017
B7	Total Current Assets	245,596,967	\$5,995,815
B8	Long Term Investments	0	\$0
B9	Fixed Assets: Property and Equipment Costs	20,947,209	\$511,389
B10	(Accumulated Depreciation)	(4,992,298)	(\$121,878)
B11	Net Property and Equipment/Net Fixed Assets (B9 + B10)	15,954,911	\$389,511
B12	Total Long Term Assets	15,954,911	\$389,511
B13	TOTAL ASSETS (Computed Total: 261,551,878)	261,551,878	\$6,385,326
	LIABILITIES		
B14	Client Savings and Time Deposits	0	\$0
B15	Other Deposits	0	\$0
B16	Short Term Borrowings (Commercial Rate)	76,072,840	\$1,857,184
B17	Total Current Liabilities	76,072,840	\$1,857,184
B18	Long Term Debt (Commerical Rate)	14,832,750	\$362,115
B19	Long Term Debt (Concessional Rate)	0	\$0
B20	Other Liabilities	8,349,262	\$203,832
B21	Total Liabilities (Computed Total: 99,254,852)	99,254,852	\$2,423,131
	NET WORTH/EQUITY		
B22	Paid-in Equity (Shareholders)	95,810,678	\$2,339,048
B23	Donated Equity (Loan Fund)	1,523,735	\$37,199
B24	Donated Equity (Cumulative Grants for Operations)	0	\$0
B25	Retained Net Profit/(Loss) - Prior Years	53,266,110	\$1,300,398
B26	Net Profit/(Loss) - Current Period	11,696,503	\$285,549
B27	Total N Worth/Equity (Computed Total: 162,297,026)	162,297,026	\$3,962,194
B28	TOTAL LIABILITIES AND NET WORTH	261,551,878	\$6,385,326

Income Statement, June 30, 2005

	US\$ Current Exchange Rate	40.9614	
I1	Interest on Loans	20,763,048	\$506,893
I2	Interest on Investments	2,374,584	\$57,971
I3	Loan Fees	3,045,625	\$74,354
I4	Total Financial Income	26,183,257	\$639,218
I5	Interest on Debt	2,747,794	\$67,083
I6	Interest Paid on Deposits	0	\$0
I7	Total Financial Costs	2,747,794	\$67,083
I8	Gross Financial Margin (I4 - I7)	23,435,463	\$572,135
I9	Provision for Loan Losses	742,338	\$18,123
I10	Net Financial Margin (I8 - I9)	22,693,125	\$554,012
I11	Salary and Benefit Expenses	5,408,972	\$132,050
I12	Administrative Expenses	2,358,212	\$57,572
I13	Other Expenses	3,229,438	\$78,841
I14	Total Operating Expenses	10,996,622	\$268,463
I15	Net Income from Operations before Taxes	11,696,503	\$285,549
I16a	Taxes	0	\$0
I16b	Net Operating Income after Taxes	11,696,503	\$285,549
I16	Donations/Grants for Operating Expenses	0	\$0
I17	Donations/Grants for Loan Capital	1,523,736	\$37,199
I17a	Non Operational Expenses or Income	0	\$0
I18	NET INCOME - PROFIT/LOSS	13,220,239	\$322,749

General and Portfolio Report, June 30, 2005

	US\$ Current Exchange Rate	40.9614	
	GNP per Capita:	\$@ERRO	
P1	No. Loans Outstanding/Active Clients [Number #]	2,615	
P2	No. of Loans Held by Women [Number #]	887	
P3	No. of Loans to First Time Borrowers [Number #]	1,261	
P4	Value of Loans Outstanding (Gross) [Amount]	193,225,711	\$4,717,263
P5	No. of Loans Disbursed During Period [Number #]	1,815	
P6	Value of Loans Disbursed During Period [Amount]	145,108,185	\$3,542,559
P7	Average Loan Term (in Weeks) [Number #]	52.00	
P8	Frequency of Payments (in Weeks) [Number #]	4.33	
P9	No. Active Savers (Voluntary & Forced) [Number #]	0	
P10	Total Savings Amount [Amount]	0	\$0
P11	Portfolio at Risk Total [Amount] (Computed Total: 6,001,707)	6,001,707	\$146,521
P12	Portfolio at Risk Less Than 30 Days [Amount]	1,697,168	\$41,433
P13	Portfolio at Risk 31-90 Days [Amount]	1,952,069	\$47,656
P14	Portfolio at Risk above 90 Days [Amount]	2,352,470	\$57,431
P15	Nominal Interest Rate [%]	24.95%	
P16	Interbank Lending Rate [%]	4.6%	
P17	Inflation Rate [%]	4%	
P18	No. of Staff (Total) [Number #]	75	
P19	No. Credit Staff (Credit Officers, Credit Mgrs) [Number #]	23	
P20	No. of Loans with Initial value < \$1000* [Number #]	943	
P21	Value of Loans with Initial Value < \$1000 [Amount]	21,587,700	\$527,025
P22	Effective Interest Rate [%]	29.12%	
P23a	Value of Renegotiated and/or Rescheduled Loans	72,023	\$1,758
P23	Value of Loans Written Off [Amount]	1,497,540	\$36,560
P24a	Portfolio by Sector (Agriculture) [Amount]	85,950,507	\$2,098,329
P24	Portfolio by Sector (Trade) [Amount]	65,446,491	\$1,597,760
P25	Portfolio by Sector (Services) [Amount]	18,718,340	\$456,975
P26	Portfolio by Sector (Manufacturing) [Amount]	4,078,979	\$99,581
P27	Client Jobs Including Entrepreneur [Number #]	4,342	

**ANNEX 2
LEGAL OPINION**

LIMITED LIABILITY COMPANY

LEGAL AGENCY «VERITAS»

133-1 Bokonbayeva St., Bishkek, 720040, tel.+996 (612) 900971, 900972, 900973, fax.
+996(312) 621249,

Settlement Account 4172000200059 at OJSC KHALYK BANK KYRGYZSTAN, MFO
330107780, INN 00702199110017,

E-mail: veritas@elcat.kg, baisal@elcat.kg

Iss. № 201 of 18.08.05r.

ACDI/VOCA

**Microcredit Agency -
Financial Fund “Bai-Tushum”**

**Recommendations to Optimize
the Process for Commercializing
the Microcredit Agency -
Financial Fund “Bai-Tushum”**

Gentlemen,

Following up on your request, the Legal Agency “VERITAS” prepared the following Recommendations to Optimize the Process for Commercializing the Microcredit Agency - Financial Fund “Bai-Tushum”, where we explain in detail our vision of individual stages of the commercialization process.

These recommendations are based on the general scheme of the Concept for Commercializing the Microcredit Agency - Financial Fund “Bai-Tushum” developed by the management of the Financial Fund. However the details substantially differ from the operational plan in terms of timing, stages and mechanisms.

GENERAL SCHEME FOR COMMERCIALIZING MCA FINANCIAL FUND “BAI-TUSHUM”

Stage One: Establishing a Limited Liability Company - the Microcredit Company “Bai-Tushum and Partners.”

Stage Two: Reorganizing the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”, into a Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners.”

Stage Three: Transforming the Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners”, into a Closed Joint-Stock Company, the Microfinance Company “Bai-Tushum and Partners.”

I. DETAILED STEP-BY-STEP SCHEME OF STAGE ONE OF THE PROCESS FOR COMMERCIALIZING MCA FINANCIAL FUND “BAI-TUSHUM” – ESTABLISHING A LIMITED LIABILITY COMPANY, THE MICROCREDIT COMPANY “BAI-TUSHUM AND PARTNERS”

1.1. The Supervisory Board of the Microcredit Agency Financial Fund “Bai-Tushum” is required to approve the proposal by the Management Board of the Microcredit Agency Financial Fund “Bai-Tushum” to establish a Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”, pass a resolution to approve the Charter of the LLC Microcredit Company “Bai-Tushum and Partners”, decide on its location and the size of its charter capital, appoint governing bodies and make decisions to authorize officials of the proposed LLC to sign financial documents.

1.2. Before a package of documents is submitted to the Bishkek City Department of Justice for the purpose of state registration of the LLC Microcredit Company “Bai-Tushum and Partners”, the MCA Financial Fund “Bai-Tushum” will be required to deposit at least 50% of the charter capital of the proposed company as per the founding documents in an account opened with any commercial bank and to submit to the justice authorities a receipt from the commercial bank confirming that the deposit has been made.

The charter capital is to be declared in the founding documents and paid in soms.

The loan portfolio of the MCA Financial Fund “Bai-Tushum” may not be contributed to the Charter Capital of the LLC Microcredit Company “Bai-Tushum and Partners.” Under Article 34 of the Law on Microfinance Organizations in the Kyrgyz Republic, the charter capital of a microcredit company is to be formed only from contributions by the founders in the domestic currency of the Kyrgyz Republic. The loan portfolio represents claims of the MCA Financial Fund “Bai-Tushum” on its borrowers and is not available as funds denominated in soms (the domestic currency) until the loan has been repaid to the Financial Fund “Bai-Tushum” by the borrowers.

The Law on Microfinance Organizations in the Kyrgyz Republic is a special-purpose law and its requirements regarding microfinance organizations prevail over the provisions of the general Law on Economic Partnerships and Companies, which allows not only cash or any assets but also ownership rights, including claims on borrowers under an earlier loan, to be contributed to the charter capital of a limited liability company.

The monetary contribution by the MCA Financial Fund “Bai-Tushum” to the charter capital of the LLC Microcredit Company “Bai-Tushum and Partners” shall be exempt from taxes.

The package of documents required for state registration of the LLC Microcredit Company “Bai-Tushum and Partners” includes:

- A resolution by the Supervisory Board of the MCA Financial Fund “Bai-Tushum” to establish a Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners” containing provisions specified in para 1 (*supra*);

- The Charter of the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners” in three original copies;
- Copies of the founding documents, including the Certificate of State Registration of the MCA Financial Fund “Bai-Tushum”;
- A receipt from the commercial bank confirming that 50% of the charter capital specified in the founding documents has been deposited in a deposit account held by the proposed Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”;
- Documents confirming the location (legal address) of the proposed Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners” (a lease deed or a free use agreement or an official letter from a potential lessor and copies of documents confirming that he is the legal owner of the premises to be subsequently leased to the proposed company);
- An application for state registration in accordance with the established form;
- A power of attorney issued in the name of the individual who will be responsible for performing the formal procedures for state registration of the proposed company;
- Authorization from the State Commission under the Government of the Kyrgyz Republic for Anti-Monopoly Policies.

The requirement that authorization from the State Commission under the Government of the Kyrgyz Republic for Anti-Monopoly Policies be provided where a proposed limited liability company’s charter capital equals or exceeds 15 thousand minimum wages (1,500,000 soms or approximately US\$37,000) is set forth in para 49.1 of the Regulation on the Procedure for Registering Legal Entities, Branches and Representative Offices with Bodies of the Ministry of Justice of the Kyrgyz Republic, approved by Ordinance No. 180 of the Ministry of Justice of the Kyrgyz Republic, dd. December 3, 2003. It is of note that this requirement is in conflict with paras 3.1., 3.2. of the Rules of Enforcement of the Anti-Monopoly Legislation of the Kyrgyz Republic in the Process of Economic Concentration, approved by Resolution No. 128 of the Government of the Kyrgyz Republic of March 15, 2005, which only require that the state anti-monopoly body of the Kyrgyz Republic be notified of the establishment of businesses whose charter capital equals or exceeds 15 thousand minimum wages. Such notice is to be submitted to the anti-monopoly body within 10 days of state registration of a new legal entity with the justice authorities of the Kyrgyz Republic. Despite this inconsistency, the Ministry of Justice does not perform state registration procedures with regard to legal entities whose charter capital equals or exceeds 15 thousand minimum wages in the absence of prior authorization from the State Commission under the Government of the Kyrgyz Republic for Anti-Monopoly Policies.

Applications by businesses for prior authorization for the purpose of state registration of a proposed legal entity are reviewed by the State Commission under the Government of the Kyrgyz Republic for Anti-Monopoly Policies within 30 days of submission.

This circumstance must be taken into account while developing an operational plan and a schedule for implementing steps involved in the commercialization of the MCA Financial Fund “Bai-Tushum.”

1.3. After the Certificate of State Registration of the LLC “Bai-Tushum and Partners” has been obtained, and following its registration with the tax authorities and the Social Fund, the manufacturing of its seal, and notarization of bank signature cards for the manager (managers) and the chief accountant of the newly-established company, a settlement account should be opened with a selected bank in which the cash earlier placed in the deposit account is to be

transferred by an order of the manager of the LLC Microcredit Company “Bai-Tushum and Partners.”

1.4. The next mandatory procedure is the registration of the newly-established Microcredit Company “Bai-Tushum and Partners” with the National Bank of the Kyrgyz Republic. For this purpose, the LLC Microcredit Company “Bai-Tushum and Partners” is required to submit to the National Bank of the Kyrgyz Republic two copies of each of the following documents:

- An application for a certificate to be issued in accordance with the established form;
- A resolution by the Founder (MCA Financial Fund “Bai-Tushum”) to establish a Microcredit Company, appoint its management, an accountant and governing bodies (the Board of Directors);
- A notarized copy of the Charter of the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”;
- A copy of the Certificate of State Registration of the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”;
- Standard forms with information about the management of the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”, its accountant and the head of its lending department;
- A document confirming that the amount of cash equal to the Microfinance Company’s minimum charter capital has been paid in as of the application submission date.

A certificate of registration of the Microcredit Company “Bai-Tushum and Partners” is to be issued by the National Bank of the Kyrgyz Republic within one month after an application has been submitted together with all the required documents.

1.5. Once the Certificate of Registration with the NBKR has been received, and all the necessary organizational and technical steps have been completed (the signing of a property lease (use) agreement between the MCA Financial Fund “Bai-Tushum” and the LLC Microcredit Company “Bai-Tushum and Partners”, the formal procedure for transferring some of the employees of the MCA Financial Fund “Bai-Tushum” to the LLC Microcredit Company “Bai-Tushum and Partners”, etc.), the Limited Liability Company, the Microcredit Company “Bai-Tushum and Partners”, will be able to begin its microcredit operations in accordance with the Law on Microfinance Organizations in the Kyrgyz Republic.

1.6. Therefore, after the Microcredit Company “Bai-Tushum and Partners” has received the Certificate of Registration with the NBKR, and all of the above steps have been completed, the MCA Financial Fund “Bai-Tushum” and the LLC Microcredit Company “Bai-Tushum and Partners” will conduct microcredit operations in parallel with each other for a certain period of time. In doing so, the LLC Microcredit Company “Bai-Tushum and Partners” will be extending loans, while the operations of the MCA Financial Fund “Bai-Tushum” will focus on collecting on previously-issued loans.

After it has paid all the taxes required under the legislation of the Kyrgyz Republic (the very same taxes the MCA Financial Fund “Bai-Tushum” is paying currently (!)), Bai-Tushum will have the right to transfer to the account or pay in cash to the cash office of the LLC Microcredit Company “Bai-Tushum and Partners” the amounts of the repaid loans and the interest earned on the loans, without paying any additional taxes, as its contribution as a Founder to the Charter Capital until the latter is fully formed in the amount specified in the Charter.

The LLC Microcredit Company “Bai-Tushum and Partners” also will not be paying any taxes on the amounts received as contributions to the Charter Capital and will have the right to use them in full to finance its operations, including the extension of microcredits.

1.7. We believe it important to address the issue of opening branches and representative offices of the LLC Microcredit Company “Bai-Tushum and Partners.”

We deem it expedient to specify in the Charter, as the LLC Microcredit Company “Bai-Tushum and Partners” is established, that the LLC will have branches in the regions where currently the MCA Financial Fund “Bai-Tushum” operates its own branches, and, following the state registration of the LLC Microcredit Company “Bai-Tushum and Partners”, to register the branches of the LLC Microcredit Company “Bai-Tushum and Partners” with the respective regional departments of justice in accordance with the procedure established by the law.

Therefore, after all registration procedures have been performed, the branches of the LLC Microcredit Company “Bai-Tushum and Partners” will conduct microcredit operations in parallel with the existing branches of the MCA Financial Fund “Bai-Tushum” virtually across the entire Kyrgyz Republic.

1.8. After the Charter Capital has been fully paid in in the amount specified in the Charter of the LLC Microcredit Company “Bai-Tushum and Partners”, the MCA Financial Fund “Bai-Tushum” should make a decision to increase the Charter Capital of the LLC Microcredit Company “Bai-Tushum and Partners” to the maximum amount that the Financial Fund “Bai-Tushum” realistically will be able to pay in over two years.

For this purpose, it will be necessary to amend the founding documents and renew state registration of the LLC Microcredit Company “Bai-Tushum and Partners.”

We believe that it makes the most sense to keep the MCA Financial Fund “Bai-Tushum” as the only founder of the LLC Microcredit Company “Bai-Tushum and Partners” until the latter has been re-organized into a closed joint-stock company. The reason is that the legislation does not impose any limits on the amount of participation by a founder (participant) that is a legal entity in the charter capital of a microcredit company. Therefore, at the first stage of commercializing the MCA Financial Fund “Bai-Tushum” there will be no need to sell part of the ACDI/VOCA stake to the employees or investors.

Should the LLC Microcredit Company “Bai-Tushum” develop an urgent need to raise additional money from investors, the following options will be available:

- Selling to potential investors part of the stake the MCA Financial Fund “Bai-Tushum” has in the charter capital and in the assets of the LLC Microcredit Company “Bai-Tushum and Partners” that has already been paid for,
- Or increasing the Charter Capital of the LLC Microcredit Company “Bai-Tushum and Partners” again, offering an investor the option of paying the amount by which the Charter Capital has been increased.

Under either scenario it will be necessary to renew the state registration of the LLC Microcredit Company “Bai-Tushum and Partners” with the justice authorities due to changes in the composition of the participants and/or increase in the Charter Capital.

It appears to make more sense for ACDI/VOCA and the employees to dispose of their shares after the LLC Microcredit Company “Bai-Tushum and Partners” has been reorganized into a Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners”; the assets

of the MCA Financial Fund "Bai-Tushum" have been transferred to the Microcredit Company; the Microcredit Agency Financial Fund "Bai-Tushum" has wound up its microcredit operations; the Registration Certificate has been submitted to the National Bank; the name Microcredit Agency Financial Fund "Bai-Tushum" has been changed to the Bai-Tushum Fund, and the necessary amendments have been made to the Charter of the Fund to accommodate the Fund's updated mission.

Limits on the ownership of shares in the charter capital of a microfinance organization are established by the Law of the Kyrgyz Republic on Microfinance Organizations only for founders (participants) of a microfinance company. In accordance with Article 13 of the Law on Microfinance Organizations, natural persons and legal entities, both residents and non-residents of the Kyrgyz Republic, can be founders and shareholders of a microfinance company, with the following proviso:

- 1) the stake held by a legal entity (with the exception of entities specified in sub-para 2) in conjunction with that owned by another legal entity controlling it, being controlled by it or being under joint control with the former entity, may not exceed 20 per cent of the microfinance company's voting shares;
- 2) an international financial organization providing support for emerging economies, a microfinance company, a bank or another legal entity that meets the criteria set forth in the regulations of the National Bank can own 100 per cent (or less) of the voting shares of the microfinance company.

Annex No.1 to the Provisional Regulation on the Establishment of Microfinance Companies in the Kyrgyz Republic, approved by Resolution No. 42/1 of the Board of the National Bank of the Kyrgyz Republic of February 11, 2002, contains a list of international organizations that can act as founders of a microfinance company without any limits on their stake. Such organizations include international financial organizations authorized by the World Bank, the Asian Development Bank, the European Bank for Reconstruction and Development or the Islamic Development Bank, as well as government organizations of the donor countries providing support for emerging economies and operating in the Kyrgyz Republic on the basis of an international agreement to which the Kyrgyz Republic is a party (e.g., USAID, GTZ, TACIS, JICA, TICA).

It follows from the list reproduced verbatim above that ACDI/VOCA is not among the organizations exempted from the restrictions established in the Law on Microfinance Organizations regarding the ownership of stakes in a microfinance company.

Consequently, ACDI/VOCA may not own more than 20% of the shares of the Closed Joint-Stock Company, the Microfinance Company "Bai-Tushum and Partners."

At the same time, Annex No. 1 to the Provisional Regulation on the Establishment of Microfinance Companies in the Kyrgyz Republic stipulates that the list of organizations that can found a microfinance company without any limits on their stake may be revised by the National Bank of the Kyrgyz Republic.

We believe it appropriate to file a petition with the National Bank of the Kyrgyz Republic asking for the MCA Financial Fund "Bai-Tushum" and/or ACDI/VOCA to be included in the list of organizations that can be founders of a microfinance company without any restrictions on the size of their stake.

As for compliance with the prudential ratios, such requirements, in addition to deposit-taking microfinance companies, also apply to companies seeking a license to accept deposits.

Under the Provisional Rules for Regulating the Activities of Microfinance Companies in the Kyrgyz Republic, approved by Resolution No. 4/2 of the Board of the National Bank of the Kyrgyz Republic of February 19, 2003, microfinance companies seeking to be licensed for accepting deposits are required to submit to the National Bank, at least one year before they apply for such a license, a letter of intent confirming the company's intent to apply to the NBKR for a license to accept deposits, and to meet the requirements set forth in the Provisional Rules.

At the same time, the company is required to submit to the National Bank a business plan setting forth its strategy, scope of operations, and performance projections for the next three years of operation, including one year-long transition period until the license to accept deposits is received and two years of deposit-taking operations; a plan for achieving and maintaining compliance with the prudential ratios and other requirements of the NBKR to the extent and in the amount established for microfinance companies accepting deposits, specifying the deadlines for meeting the ratios and other requirements and achieving the target compliance levels; as well as a plan for building up the capital to the minimum charter capital requirement established for microfinance companies authorized to accept deposits, indicating the deadlines, target levels and sources of building up the capital.

Upon submission of its letter of intent to the National Bank of the Kyrgyz Republic, the microfinance company is required to meet the following prudential ratios established by the National Bank:

- The minimum equity requirement;
- The capital adequacy ratio;
- The maximum risk concentration per borrower;
- The liquidity ratio;
- The cap on the risk of deposit repayment;
- Total debt of the employees of the microfinance company who took out consumer loans at the microfinance company;
- The cap on investment in each microfinance organization or bank;
- The cap on total investment in microfinance organizations and banks.

Since the Provisional Rules for Regulating the Activities of Microfinance Companies in the Kyrgyz Republic do not apply to microcredit companies, then, technically, the Closed Joint-Stock Company the Microcredit Company "Bai-Tushum and Partners", will not be required to meet the above requirements. However, down the road this will certainly be an obstacle to obtaining a National Bank license to accept deposits.

In this regard, we recommend that provisions be made for submitting a letter of intent to the National Bank one year after the state registration of CJSC "Bai-Tushum and Partners" to voluntarily undertake to meet the prudential ratios established by the National Bank of the Kyrgyz Republic for microfinance companies, as well as to meet the other requirements established by the National Bank for the purpose of regulating the activities of microfinance companies.

In the light of the above, we believe that failure to comply with the established prudential ratios during one year before filing an application for a license to accept deposits was the reason why CJSC MCC Finca was denied such license.

Regarding your question about limited liability company certificates, please be advised that the legislation of the Kyrgyz Republic does not provide for limited liability companies to issue certificates to their participants. A participant's ownership of a stake in the charter capital of a limited liability company is confirmed by the founding documents of the LLC (the charter, the founding agreement), which reflect the size of the stake held by each of the participants.

II. STEP-BY-STEP SCHEME OF STAGE TWO OF THE PROCESS FOR COMMERCIALIZING THE MCA FINANCIAL FUND "BAI-TUSHUM" – REORGANIZING THE LIMITED LIABILITY COMPANY, THE MICROCREDIT COMPANY "BAI-TUSHUM AND PARTNERS", INTO THE CLOSED JOINT-STOCK COMPANY THE MICROCREDIT COMPANY "BAI-TUSHUM AND PARTNERS"

2.1. The decision to reorganize the LLC Microcredit Company "Bai-Tushum and Partners" into the Closed Joint-Stock Company the Microcredit Company "Bai-Tushum and Partners" is to be taken by the supreme governing body of the limited liability company, *i.e.* its founder, the Bai-Tushum Fund represented by its authorized bodies. The reorganization decision must endorse a deed of conveyance listing the rights and obligations assigned to the successor to the reorganized legal entity – the Closed Joint-Stock Company the Microcredit Company "Bai-Tushum and Partners." The drawing up of the deed of conveyance is to be preceded by taking stock of the assets and cash liabilities of the LLC Microcredit Company "Bai-Tushum and Partners" undergoing reorganization. The deed of conveyance together with copies of the written notices to the creditors and the founding documents is to be submitted to the justice authorities for the purposes of state registration of CJSC Microcredit Company "Bai-Tushum and Partners."

A notice is to be given in writing to the creditors no later than one month prior to the completion of the reorganization process and the submission of documents to the registration authority for re-registration or for registration of the legal entity established as a result of the reorganization, or for registration of the winding-up of the reorganized legal entity.

In the event of reorganization (merger, acquisition, transformation) of business entities whose total assets exceeded 100 thousand minimum wages during the most recent financial period, authorization for reorganization from the State Commission under the Government of the Kyrgyz Republic for Anti-Monopoly Policies must be submitted additionally (para 30 of the Regulation on the Procedure for Registering Legal Entities, Branches and Representative Offices by Bodies of the Ministry of Justice of the Kyrgyz Republic, approved by Ordinance No. 180 of the Ministry of Justice of the Kyrgyz Republic, dd. December 3, 2003).

In addition to other provisions stipulated by the Law on Joint-Stock Companies, the charter of a closed joint-stock company is also required to contain information about the number and classes of shares issued by the company.

2.2. After the procedure for state registration of the winding-up of the LLC Microcredit Company "Bai-Tushum and Partners" and the establishment of the CJSC Microcredit Company "Bai-Tushum and Partners" with the justice authorities has been completed, notice must be given to the National Bank and the Microcredit Company Registration Certificate must be replaced.

It will also be necessary to notify all borrowers and partners of the LLC Microcredit Company "Bai-Tushum and Partners" of the company's completed reorganization and its universal successor.

The reorganization of the LLC Microcredit Company "Bai-Tushum and Partners" into a closed joint-stock company virtually will not interrupt the operations of the company, with the exception of several days when the CJSC seal is being manufactured, while the LLC seal will have been officially surrendered to the licensing authority of the Ministry of the Interior.

No additional taxes will be levied in connection with the reorganization procedure or the transfer of assets under the deed of conveyance.

2.3. CJSC Microcredit Company "Bai-Tushum and Partners" will be required to register the founding issue of shares with the State Commission for the Securities Market under the Government of the Kyrgyz Republic within one month of the date of its state registration as a legal entity.

The decision to issue shares, in accordance with the requirements of the Standards for Issuing Shares to Be Placed at the Time When Joint-Stock Companies are Founded, approved by Resolution No. 40 of the State Commission for the Securities Market under the Government of the Kyrgyz Republic, dd. June 4, 2004, is to be endorsed by the founder and is to meet such standards in form and substance.

Since as of the date of registration of the joint-stock company its charter capital declared in the founding documents should be fully paid-in, the share issue and placement report is to be registered concurrently with the state registration of the share issue with the State Commission for the Securities Market under the Government of the Kyrgyz Republic.

The following documents are to be submitted to the State Commission for the Securities Market under the Government of the Kyrgyz Republic for the purpose of state registration of the share issue and registration of the report on the results of the issue of shares placed at the time when the company was founded:

- an application for state registration of the share issue and registration of the report on the results of the share issue in accordance with the established form;
- a copy of the certificate of state registration of the joint-stock company with the justice authorities;
- a copy of the charter of the joint-stock company;
- the founder's decision to establish a company and issue shares;
- two copies of the decision to issue shares;
- a receipt from the bank confirming that the charter capital has been fully paid in and specifying the form of payment;
- a document confirming that a lump-sum commission fee for state registration of the share issue has been paid;
- two copies of the report on the results of the issue and placement of shares;
- an excerpt from the shareholder register issued by the company's registrar;
- a copy of the NBKR certificate and license.

State registration of the share issue and registration of the report on the results of the issue and placement of shares are performed by the State Commission for the Securities Market under the Government of the Kyrgyz Republic within 30 days after the date when the issuer submitted all the necessary documents.

The lump-sum commission fee for state registration of the share issue is 0.5% of the face value of the shares being placed.

2.4. In accordance with the provisions of the Law on Joint-Stock Companies, the shareholders' title to the shares they own is to be recorded in the Shareholder Register. A closed joint-stock company has the right to independently keep and maintain its shareholder register. For this purpose, the joint-stock company is required to appoint a person responsible for maintaining the shareholder register. That person must then obtain a qualifications certificate from the authorized government agency of the Kyrgyz Republic in charge of regulating the securities market authorizing him/her to maintain the shareholder register.

The responsibility for maintaining the shareholder register may be delegated to an independent registrar licensed to conduct such activities.

2.5. After the procedure for reorganizing the LLC into a CJSC has been completed, the Bai-Tushum Fund may sell part of the shares it owns to potential investors. In doing so, it will be economically expedient to sell shares to investors at their market value. The proceeds from the sale of shares will be credited to the account of the Bai-Tushum Fund and may be subsequently used by it for purposes it may determine.

At the same stage, part of the shares may be sold to employees of the CJSC Microcredit Company "Bai-Tushum and Partners" and ACDI/VOCA at a reduced price. The right to set a reduced price for the shares shall be vested in the Supervisory Board of the Bai-Tushum Fund which will have officially changed its mission by that time.

With regard to your question about the liability of the shareholders and the directors of the joint-stock company, in accordance with Article 3 of the Law on Joint-Stock Companies, shareholders are not liable for the obligations of the joint-stock company and bear the risk of losses in connection with its activities to the extent of the value of their shares. The exceptions are cases where a joint-stock company goes bankrupt through the fault of its shareholder or when the shareholder has failed to make the decision to declare the company bankrupt while aware of its insolvency. These provisions of the legislation of the Kyrgyz Republic are hardly enforced. At any rate, there have been almost no officially published facts of shareholders of bankrupt companies being held liable.

Article 65 of the Law on Joint-Stock Companies stipulates that officers of a joint-stock company are liable to the company for losses caused by their culpable actions (omission). In accordance with that Law, officers of a joint-stock company are:

- members of the Board of Directors;
- members of the executive body;
- members of the auditing commission;
- the company's secretary.

Members of the Board of Directors, the executive body and the auditing commission of the company who voted against a decision that resulted in losses to the company, or who did not take part in the vote shall not be liable for losses inflicted on the company.

If a report on the financial and business performance substantially misrepresents the financial situation of the joint-stock company, the officers who signed such documents shall be held vicariously liable to third parties who suffered pecuniary damages as a result of that.

There are potential possibilities for insuring the liability of directors and officers of joint-stock companies in the Kyrgyz Republic. However, this type of insurance is an absolutely new product in the market of insurance services and is available, in our opinion, only from 2-3 insurance companies.

III. SCHEME OF STAGE THREE OF THE PROCESS FOR COMMERCIALIZING THE MCA FINANCIAL FUND “BAI-TUSHUM” – REORGANIZING THE CLOSED JOINT-STOCK COMPANY THE MICROCREDIT COMPANY “BAI-TUSHUM AND PARTNERS” INTO THE CLOSED JOINT-STOCK COMPANY THE MICROFINANCE COMPANY “BAI-TUSHUM AND PARTNERS”

3.1. At this stage, it will be necessary to once again renew state registration of the Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners” with the justice authorities in connection with a change in its name and type of business.

Once the microfinance company status has been granted, prior approval will have to be obtained from the National Bank of the Kyrgyz Republic for any changes that will be subsequently made to the founding documents of the Closed Joint-Stock Company the Microcredit Company “Bai-Tushum and Partners.”

3.2. The process for obtaining a National Bank license for the operations of the Microfinance Company “Bai-Tushum and Partners” is going to be the most difficult in terms of preparations and technical implementation.

Before the license is obtained, the microfinance company is prohibited from engaging in any activities as a legal entity, with the exception of organizational work involved in the establishment of the company.

In order to receive the license, the following documents must be submitted to the National Bank:

- an application for a license;
- notarized copies of the founding documents;
- detailed information about the shareholders;
- a business plan setting forth the company’s strategy, areas and scope of operation for the first three years of its work;
- detailed information about the general organizational structure of the company;
- a list of members of the Board of Directors and the Management Board of the company identifying the chairmen and their first deputies, and indicating the full name and address of each individual on the list, as well as containing evidence to confirm that they meet the requirements established by the NBKR in its Procedure for Evaluating Professional Qualifications of Executives of Banks and Other Financial and Credit Institutions Licensed by the NBKR, approved by Resolution No. 19/2 of the NBKR Management Board of August 12, 1998.

Individuals appointed heads of large units of the company, including the chief accountant, management of the internal audit department, the credit department, the manager of the company’s assets and liabilities, will also need to provide information specified in the sub-para above as well as data on previous employment.

- a document confirming that the charter capital has been paid in;
- an auditing organization's opinion on the financial situation of the founders or other information confirming their financial wealth;
- a document confirming that payment for the issuance of the license has been made.

If the applicant is a company with foreign capital, in addition to the documents listed above, the following duly legalized documents will have to be submitted:

1) for foreign banks, subsidiaries of foreign banks, microfinance organizations, credit organizations, financial institutions (insurance companies, investment companies, pension funds, etc.):

- the charter or any other document confirming the status of the financial-credit institution and its published balance sheets for the past three years;
- the decision by the relevant authorized body of the foreign founder (participant) to take part in the establishment of a company in the Kyrgyz Republic or to open a subsidiary;

2) for nonbank foreign legal entities:

- an excerpt from the trade register, a certificate or any other document confirming that the foreign participant is a legal entity under the laws of the country where such legal entity was registered;
- the decision by the relevant body to take part in the establishment of a microfinance company;
- the charter and published balance sheets for the past three years;
- an auditing organization's opinion on the financial situation of such entity or any other information confirming its financial wealth;

3) for foreign nationals and stateless persons:

- a copy of the passport or any other identification document;
- a document confirming the financial situation of the applicant or any other information confirming his/her financial wealth;
- references from at least two foreign legal entities or natural persons known to be solvent.

The NBKR is to make a decision on the issuance of the license within 30 days, however, the NBKR may extend the period for reviewing the application and all the required documents by 10 business days.

Regarding the system of stock options: Although a stock exchange has been operating in the Kyrgyz Republic for ten years, the Kyrgyz stock market is generally underdeveloped, unstable and is associated with high risks. Stock options are virtually not used as financial instruments in Kyrgyzstan. No stock options are traded on the Kyrgyz stock exchange. The Law of the Kyrgyz Republic on the Securities Market contains a definition of derivatives and indicates that the particulars of circulation of derivatives are to be set forth in the regulations of the State Commission for the Securities Market under the Government of the Kyrgyz Republic. At the same time, such regulations have not been adopted in Kyrgyzstan to date.

As for the possibility of entering into put or call options, the provisions of the Civil Code of the Kyrgyz Republic do not prohibit entering into such agreements. However, such agreements can only be made either between shareholders or between the issuer and a shareholder.

Sincerely,

Natalia Gallyamova,

Vice-President,
Senior Partner,
Legal Agency «VERITAS»

ANNEX 3
DRAFT CHARTER
MICRO CREDIT COMPANY “BAI TUSHUM & PARTNERS” LLC

APPROVED BY THE PARTICIPANT
Decision made on August “____”, 2005

CHARTER
Of the LIMITED LIABILITY COMPANY, the MICROCREDIT
COMPANY “BAI-TUSHUM AND PARTNERS”

Bishkek 2005

CONTENTS

Article 1
GENERAL PROVISIONS

Article 2
LEGAL STATUS OF THE COMPANY

Article 3
RESPONSIBILITIES OF THE COMPANY AND ITS PARTICIPANT

Article 4
OBJECTIVES AND ACTIVITIES OF THE COMPANY

Article 5
LENDING RULES

Article 6
RIGHTS AND RESPONSIBILITIES OF THE PARTICIPANT

Article 7
AUTHORIZED CAPITAL AND ASSETS OF THE COMPANY

Article 8
TRANSFER OF THE PARTICIPANT’S SHARE (OR PART OF IT) IN THE
ASSETS OF THE COMPANY

Article 9
PLEDGING THE PARTICIPANT’S SHARE (OR PART OF IT) IN THE ASSETS
OF THE COMPANY

Article 10
PROFITS, LOSSES AND RESERVES OF THE COMPANY

Article 11
MANAGING THE COMPANY

Article 12
PARTICIPANT

Article 13
BOARD OF DIRECTORS

Article 14
MANAGEMENT BOARD

Article 15
ACCOUNTING AND FINANCIAL REPORTING

Article 16
AUDITS

Article 17
EMPLOYEES AND LABOR RELATIONS

Article 18
REORGANIZATION OR LIQUIDATION OF THE COMPANY

Article 19
FINAL PROVISIONS

I. GENERAL PROVISIONS

1.1. The limited liability company, the Microcredit Company “Bai-Tushum and Partners”, subsequently referred to as “Company”, is established by a decision of the Company Founder made on August ___ 2005, under the provisions of the Constitution of the Kyrgyz Republic, the Civil Code of the Kyrgyz Republic, the Law of the Kyrgyz Republic “On Economic Partnerships and Associations”, the Law of the Kyrgyz Republic “On Microfinance Organizations”, and normative documents issued by the National Bank of the Kyrgyz Republic.

1.2. The Founder (Participant) of the Company is the Microcredit Agency Financial Fund “Bai-Tushum” located at 216 Toktogul St., Bishkek, Kyrgyz Republic, Registration # , OKPO code , Certificate of State Re-registration of a Legal Person GPR 075796 of November 19, 2004.

1.3. The name of the Company:

In full:

in Russian - The limited liability company “Microcredit Company “Bai-Tushum and Partners”

in Kyrgyz - Zhoopkerchiligi Chektelgen koomu “Bai-Tushum and Partners”,
Mikrokredittik kompaniaysy

In English - Limited liability company “Bai – Tushum & Partners”,
Micro Lending Company

Abbreviated:

In Russian - OsOO MCC “Bai-Tushum and Partners”

In Kyrgyz - ZhChK “Bai-Tushum and Partners” MKK

In English - MLC “Bai – Tushum & Partners” LLC

1.4. The organizational and legal form of the Company is a limited liability company.

1.5. The legal address of the Company is at 216 Toktogul St., Bishkek, Kyrgyz Republic.

1.6. To implement the goals and objectives set forth herein the Company may establish branches, representative offices outside its own location, either within or beyond the borders of the Kyrgyz Republic, in the manner provided for by the legislation of the Kyrgyz Republic and/or relevant foreign nations.

1.7. Location of the Company’s branches:

1.7.1. The Osh branch of the limited liability company “Microcredit company “Bai-Tushum and Partners”” - 180A Kurmanzhan Datka St., Osh, 714000.

1.7.2. The Jalal-Abad branch of the limited liability company “Microcredit company “Bai-Tushum and Partners”” - 8 Matrosov St., Jalalabad, 715607.

1.7.3. The Bishkek branch of the limited liability company “Microcredit company “Bai-Tushum and Partners”” - Suites 3-4, 84 Ibraimov St., Bishkek, 720000.

2. THE LEGAL STATUS OF THE COMPANY

2.1. The Company is a for-profit entity based on the private property of its Participant.

2.2. The Company is established and operates in strict accordance with the requirements of the legislation of the Kyrgyz Republic, this Charter and the Company’s normative documents and is liable for its obligations with its entire assets.

2.3. The Company shall acquire the status of a legal person upon its government registration with the justice authorities of the Kyrgyz Republic. The Company shall acquire the status of a specialized non-banking lending institution upon receipt of a certificate issued by the National Bank of the Kyrgyz Republic.

2.4. The Company operates as a self-sufficient, self-financing and fully independent economic entity. The Company functions via entering into agreements, contracts and arrangements, and by engaging in any other activities that are not prohibited by the laws of the Kyrgyz Republic and are aimed at accomplishing its goals as per this Charter.

2.5. The Company shall take advantage of all the rights available to it under the legislation of the Kyrgyz Republic, including but not limited to the right to:

- Enter into civil law-based relationships with other legal and natural persons;
- Exercise all owner's rights with respect to its property, enter on its own behalf into agreements (contracts), bear and perform responsibilities, and also appear as a plaintiff or respondent in a court of law, arbitration tribunal, take part in administrative proceedings, effect settlements;
- Independently engage in foreign economic activities, including provision of microcredits to legal entities not resident in the Kyrgyz Republic;
- Open and manage bank accounts in local and foreign currencies in the Kyrgyz Republic and abroad;
- Establish subsidiaries, open branches and representative offices, participate in the establishment and activities of associations, for-profit or non-profit organizations in the Kyrgyz Republic and abroad.

The Company may transfer part of its property to subsidiaries, branches or representative offices, as well as associations, for-profit and non-profit organizations.

2.6. The Company has separate assets, a separate balance sheet, maintains current, FX and other accounts in the banks of the Kyrgyz Republic and foreign countries, owns a round seal, stamps and letterhead carrying its name, and all the other essential instruments.

2.7. The term of operation of the Company is not limited. The period of the Company's operation commences as of the date of registration and continues until its activities are terminated or the Company is liquidated following the procedure set forth herein and in the legislation of the Kyrgyz Republic.

2.8. The working language of the Company is Russian.

3. RESPONSIBILITIES OF THE COMPANY AND ITS PARTICIPANT

3.1. The Company is liable for its obligations with all its property and assets that may be used to satisfy claims by creditors in accordance with the legislation of the Kyrgyz Republic.

3.2. The Company is not liable for the Participant's obligations, and the Participant is not liable for the obligations of the Company. The Participant's risk of losses resulting from the activities of the Company shall be to the extent of the Participant's contribution to the Authorized Capital of the Company.

If the Participant has not fully made its contribution to the Authorized Capital of the Company, it bears joint responsibility under the Company's obligations to the extent of the value of the unpaid-for part of the contribution.

3.3. The Company is not liable under the obligations of the State, nor is the State liable under the obligations of the Company.

4. OBJECTIVES AND ACTIVITIES OF THE COMPANY

4.1. The principal objective of establishing the Company is to derive a profit by virtue of engaging in the provision of affordable microcredits, thus making a contribution to sustainable development of the economy of the Kyrgyz Republic in order to foster the prosperity of society, and help improve the standard of living by providing financial and consulting services, technical assistance through financing SMEs.

4.2. The Company engages in the following activities:

4.2.1. Provides microcredits to legal and natural persons in the Kyrgyz Republic and other countries in accordance with the legislation of the Kyrgyz Republic and other foreign countries on terms agreed upon with the borrowers.

4.2.2. Provides consulting and information assistance to the borrowers that are legal persons.

4.2.3. Buys and sells debentures (factoring).

4.2.4. Conducts financial leasing transactions.

4.2.5. Provides other services to the Company's customers arising from the Company's microcredit activities.

4.2.6. Engages in economic and other activities that are not prohibited by the legislation of the Kyrgyz Republic.

4.3. In regard to licensed activities, including activities specified in pp. 4.2.3., 4.2.4. of this Charter, the Company operates on the basis of a license of the National Bank of the Kyrgyz Republic to be obtained in the manner provided for by the legislation of the Kyrgyz Republic.

4.4. To accomplish the above objectives the Company may engage in any required legal commercial activity that is not prohibited by the legislation of the Kyrgyz Republic; such activities must be authorized by the Board of Directors, if required by the Company's Charter and normative documents.

5. LENDING RULES

5.1. The maximal amount of a single micro loan that the Company may extend to a person shall not exceed 5 (five) % of the value of the net assets of the Company.

5.2. Credits may be provided to natural and legal persons in accordance with the legislation of the Kyrgyz Republic, provisions of this Charter and/or Lending Policies of the Company, which govern the extension of credits.

5.3. Classes of borrowers and lending terms are defined in the Lending Policies and procedures of the Company drafted and approved by the Company's Board of Directors.

5.4. The borrowers' obligations to repay microcredits to the Company must be secured in accordance with the requirements of the Lending Policies. Upon decisions of the Management Board, the Company may extend unsecured credits to certain borrowers.

5.5. Decisions to extend microcredits are made by the Company's Lending Committee whose membership is approved by the Company's Board of Directors. The decision-making procedure is set forth in the Company's Lending Policies and in procedures approved by the Company's Board of Directors.

5.6. The principal area of the Company's activities is the territory of the Kyrgyz Republic but the Company may also operate beyond its borders.

6. RIGHTS AND RESPONSIBILITIES OF THE PARTICIPANT

6.1. The Company's Participant may:

6.1.1. Participate in the running of the Company in the manner determined in this Charter and the legislation of the Kyrgyz Republic, which includes distribution of the Company's profits.

6.1.2. Derive profits earned in accordance with the established procedure, after the payment of taxes provided for by the legislation of the Kyrgyz Republic, in the manner determined in this Charter;

6.1.3. Obtain information about the Company's financial and economic activities, access accounting data, statements and other documents;

6.1.4. Leave the Company following the established procedure;

6.1.5. In accordance with the legislation of the Kyrgyz Republic, freely dispose of its share in the Authorized Capital and the assets of the Company, including pledge, sell or otherwise transfer it for the benefit of third persons.

6.1.6. In the event of liquidation of the Company, receive part of its assets available following settlement with the creditors, or the value of such assets.

6.1.7. The Participant may also have other rights provided for in the Charter and the legislation of the Kyrgyz Republic.

6.2. The Company's Participant is responsible for:

6.2.1. Performing its assumed obligations before the Company, including making a contribution to the Authorized Capital of the Company in the manner determined in this Charter and the legislation of the Kyrgyz Republic.

6.2.2. Observing provisions of this Charter;

6.2.3. Participating in the Company's activities in the manner determined in this Charter and the legislation of the Kyrgyz Republic;

6.2.4. Assisting in accomplishing the goals and objectives of the Company and further expanding its activities;

6.2.5. Not disclosing information declared by the Company to be a commercial secret, other confidential or insider information on the Company or activities;

6.2.6. The Participant may also have other responsibilities provided for by the Charter and the legislation of the Kyrgyz Republic.

7. AUTHORIZED CAPITAL AND ASSETS OF THE COMPANY

7.1. The Company's Assets consist of its Authorized Capital, Reserve Fund and other means and monies formed in the manner determined by the legislation of the Kyrgyz Republic and the Company's regulations.

7.2. To enable activities of the Company the Participant forms its Authorized Capital in the amount of 50,000,000 (fifty million) soms, which is 100% of the share in the Company's Authorized Capital.

7.3. The Company's Participant is responsible for the timeframe and manner of making its contribution to the Authorized Capital of the Company in accordance with the legislation of the Kyrgyz Republic.

7.4. The Authorized Capital of the Company may be increased or decreased by the Participant. The Company's Authorized Capital may only be decreased after all the creditors of the Company have been personally notified in writing. The Authorized Capital may not be decreased below the amount set by the National Bank of the Kyrgyz Republic.

7.5. The Participant's decision to change the amount of the Authorized Capital becomes effective upon government re-registration of the Company.

7.6. The Company enjoys the right of ownership with respect to its assets. The Company may own, use, and dispose of its assets. The Company may take any action with respect to its assets that is not in conflict with the legislation of the Kyrgyz Republic and the provisions of this Charter.

7.7. The assets of the Company arise from the following sources:

- the Participant's contributions to the Company's Authorized Capital;
- income generated by the Company's activities;
- assets transferred to the Company by legal or natural persons;
- other sources not prohibited by the legislation of the Kyrgyz Republic.

8. TRANSFER OF THE PARTICIPANT'S SHARE (OR PART OF IT) IN THE ASSETS OF THE COMPANY

8.1. The Company's Participant may sell or otherwise assign its share in the assets of the Company or part thereof to another person in the manner provided for by this Charter and the legislation of the Kyrgyz Republic.

8.2. Should the Participant's share be acquired by the Company the latter is required to sell it to third persons within one month of the purchase or to decrease its Authorized Capital.

8.3. Its share in the Company is conveyed to the Participant's legal successors in the manner provided for by the legislation of the Kyrgyz Republic.

9. PLEDGING THE PARTICIPANT'S SHARE (OR PART OF IT) IN THE ASSETS OF THE COMPANY

9.1. The Company's Participant may pledge its share in the Company's assets or part thereof to third persons to secure performance of its obligations.

10. PROFITS, LOSSES AND RESERVES OF THE COMPANY

10.1. The Company's year's worth of profits formed in accordance with the established procedure, after the payment of taxes provided for by the legislation of the Kyrgyz Republic, in accordance with the decision of the Company's Participant, are made available to the Participant or used for the Company's development needs by forming the Company's special funds.

10.2. The Company's losses are covered from its reserves, as well as from the Company's internal funds and assets.

10.3. The Company categorizes its assets and loan portfolio in accordance with the regulations issued by the National Bank of the Kyrgyz Republic.

10.4. The Company establishes potential losses reserves, writes off problem and bad loans, and adjusts reserves to cover potential losses in accordance with the rules and regulations of the National Bank of the Kyrgyz Republic.

10.5. Expenses incurred in forming reserves to cover potential loan-related losses are considered the Company's costs and are deductible from the taxable base if this is provided for by the tax legislation of the Kyrgyz Republic.

11. MANAGING THE COMPANY. RESPONSIBILITIES OF OFFICERS.

CONFLICT OF INTERESTS

- 11.1. The Company's activities are managed by the following:
- The Participant;
 - The Board of Directors;
 - The Management Board.
- 11.2. The Company's activities are managed in accordance with the provisions of this Charter and the legislation of the Kyrgyz Republic.
- 11.3. Members of the Board of Directors and the Management Board are officers of the Company and may be held liable in accordance with the legislation of the Kyrgyz Republic.
- 11.4. Except for when the legislation of the Kyrgyz Republic provides otherwise, the Participant and/or an officer of the Company may not be held personally responsible for any debts, obligations or liabilities of the Company with respect to third persons solely for the reason of being the Participant or engaging in an activity as an officer of the Company.
- 11.5. Officers running the Company and its governing bodies are recognized as having personal financial interest in a matter if they or their relatives have rights of ownership with respect to the property of the following legal or natural persons, maintain an employment relationship with them, or are their creditors:
- 11.5.1. Legal or natural persons that are the Company's suppliers;
 - 11.5.2. Legal or natural persons that are the Company's customers;
 - 11.5.3. Legal or natural persons benefiting from the disposing of the Company's assets;
 - 11.5.4. Legal or natural persons whose full or partial property is purchased by the Company.
- 11.6. Where a Company officer or his close relatives have a financial interest in an agreement to which the Company is or intends to become a party, and also in the event of a conflict of interest between the officer and the Company's current or future agreements:
- 11.6.1. The officer is required to notify the Board of Directors of the conflict of interest before the agreement is entered into;
 - 11.6.2. The agreement must be approved by a majority of the members of the Board of Directors who do not have an interest in such an agreement.
- 11.7. If a Company officer has any doubts as to whether or not his actions or relationships will cause a conflict of interest he must notify the Board of Directors of his interest so that the latter can consider and decide on the matter.

12. THE PARTICIPANT

- 12.1. The Participant is the highest governing body of the Company.
- 12.2. The exclusive competence of the Participant comprises:
- 12.2.1. Changes in the amount of the Company's Authorized Capital.
 - 12.2.2. Decision-making on reorganization or liquidation of the Company.
 - 12.2.3. Amending or adding to the Company's Charter.
 - 12.2.4. Approving annual statements and accounting balance sheets, as well as auditors' opinions and reports, setting the procedure of and making the decision on distributing profits and covering losses.
 - 12.2.5. The Participant elects, recalls, and terminates ahead of time the authority of the members of the Board of Directors, Chairman of the Board of Directors, members of the Management Board.

12.2.6. The Participant appoints the Chairman of the Board of Directors (who is also the General Manager), the CFO, the Chief Accountant, and the Internal Auditor of the Company.

12.2.7. The Participant relieves from their duties the Chairman of the Board of Directors (who is also the General Manager), the CFO, the Chief Accountant, the Internal Auditor of the Company in accordance with the terms of their employment contracts and the legislation of the Kyrgyz Republic.

12.3. The Participant's competence also includes:

12.3.1. Approving the Company's Charter.

12.3.2. Determining the principal avenues of activity of the Company, approving plans and reports on their implementation.

12.3.3. Approving the Company's financial plans.

12.3.4. Decision-making on the Company's involvement in the activities of other for-profit entities.

12.3.5. Approving rates of compensation for the members of the Board of Directors.

12.4. The Participant may make a decision on any matter of the Company's activities.

12.5. Matters within the competence of the Participant may be referred by the Participant to the Board of Directors and/or the Management Board of the Company for decision-making purposes, except for matters delegated by this Charter and the legislation of the Kyrgyz Republic to the exclusive competence of the Participant.

12.6. The Participant's decisions are binding upon the Board of Directors, the Management Board and the employees of the Company.

13. BOARD OF DIRECTORS

13.1. The Board of Directors manages the activities of the Company on matters within its competence and controls the activities of the Company's Management Board.

13.2. The Board of Directors is approved by the Company's Participant.

13.3. The Board of Directors must comprise at least three but no more than seven members. The actual number of members of the Board of Directors is determined by the Participant.

13.4. The Board of Directors is elected for a two-year term. A member of the Board of Directors may not hold that position for more than three consecutive terms.

13.5. Any competent and able-bodied individual may be considered as a candidate to the Board of Directors, except for close relatives of the current members of the Board of Directors and Management Board (including, but not limited to the parents, children and relatives of the members' spouses). The Participant may impose additional requirements on prospective Board of Directors members.

13.6. The Company pays members of the Board of Directors compensation for their work on the Board of Directors in the amount set by the Participant, and also reimburses reasonable expenses incurred by them in the performance of their responsibilities on the Company's behalf.

13.7. Within its competence the Board of Directors:

13.7.1. Determines the organizational structure of the Company;

13.7.2. Approves internal documents defining the operating procedures of the executive bodies of the Company, the operating policies of the Company (including on microcredits, personnel, and accounting).

13.7.3. Makes decisions on opening branches and representative offices, on establishing, reorganizing, and liquidating subsidiaries, as well as approves their charters, bylaws and other internal documents.

13.7.3. Approves annual statements and accounting balance sheets of the Company's branches and subsidiaries.

13.7.4. Approves rates of compensation of the officers of the Company's branches, representative offices, and subsidiaries.

13.7.5. Tentatively reviews opinions and reports submitted by the Internal Auditor.

13.7.6. Submits for the Participant's consideration recommendations on issues within the exclusive competence of the Company's Participant.

13.7.7. Reviews current reports by the Management Board on the activities of the Company.

13.7.8. Analyzes the actions of the Company's Management Board to apply investment, technical, and pricing rules, as well as the day-to-day management of the Company's activities.

13.7.9. Initiates audits (both in-house, and outside) of the Company's activities.

13.7.10. Submits recommendations to the Participant to amend the Authorized Capital of the Company and suggests relevant amounts.

13.7.11. Makes decisions for the Company to engage in new types of commercial activities other than the core activity.

13.7.12. Makes decisions on the Company conducting transactions exceeding amounts equivalent to _____ (_____) US dollars upon conversion into soms at the official exchange rate set by the National Bank of the Kyrgyz Republic as of the date of such decision-making.

13.7.13. Makes decisions on pledging and disposing of the Company's assets, except for assets transferred to the Company as collateral for microcredits.

13.7.14. Makes decisions on the Company taking out credits (loans).

13.7.15. Submits recommendations to the Participant regarding distribution of profits and covering losses of the Company;

13.7.16. Approves the membership of the Company's Lending Committee as suggested by the Company's Management Board.

13.7.17. Approves the terms of employment agreements (contracts) entered into with members of the Management Board, General Manager, CFO, Chief Accountant, and Internal Auditor of the Company.

The Board of Directors is authorized to delegate its powers and rights with regard to entering into employment contracts with individuals specified in this paragraph of the Charter to the Chairman of the Management Board of the Company (General Manager) or to any of the members of the Board of Directors of the Company.

13.7.18. Approval of rates of compensation for the members of the Management Board and the Internal Auditor of the Company.

13.7.19. Approves the Regulation "On Internal Audits of the Company" and internal audit instructions and procedures.

13.8. The following actions and types of operations may not be performed by the Board of Directors or any officer of the Company unless previously cleared by the Participant:

13.8.1. Submission of any insolvency or bankruptcy petition, agreement to a forced out-of-court bankruptcy petition, or any other action in support of the above.

13.9.2. Distribution of the assets of the Company in a manner that is different from what is provided for in this Charter.

13.9.3. Performance of operations which may result in the Company suffering losses (other than usual risks arising from extension of microcredits, and other than advance payments made to employees against payable compensation or to cover reimbursable costs).

13.10. The procedure of calling and conducting scheduled and extraordinary meetings of the Board of Directors, as well as the procedure for the Board of Directors to make decisions without calling meetings is determined by the Company's normative documents.

13.11. The Board of Directors has a quorum if a meeting is attended by two out of three, or three out of four (five), or four out of six (seven) current members of the Board of Directors. Decisions are made by a simple majority of votes. If the votes are split evenly, the vote of the Chairman of the Board of Directors is the decisive vote.

13.12. The Company's Board of Directors may make decisions without calling a meeting - by submitting questions in writing. Such decision-making requires consensus.

13.13. The Chairman of the Board of Directors is elected by the Board of Directors from among its members for a two-year term, which may be extended upon decision of the Company's Participant.

13.14. The Chairman of the Board of Directors shall:

13.14.1. Organize the work of the Company's Board of Directors;

13.14.2. Enter into employment agreements (contracts) with the General Manager and Internal Auditor.

13.15. The Board of Directors submits to the Participant an annual report on its activities following the procedure set forth in the Company's normative documents.

14. MANAGEMENT BOARD

14.1. The day-to-day activities of the Company are managed by the Management Board comprising no fewer than 3 and no more than 5 members approved by the Company's Participant for a term of three years.

14.2. The Management Board reports to the Board of Directors and the Participant and is responsible for implementing their decisions.

14.3. The competence of the Management Board includes all issues pertaining to the activities of the Company, except for matters in the competence of the Participant and the Board of Directors, in particular:

14.3.1. Drafting internal rules and procedures of the Company, including Lending Policies and Procedures.

14.3.2. Developing business plans and other programs of the Company's financial and commercial activities.

14.3.3. Participation in the meetings of the Board of Directors with a deliberative vote.

14.3.4. Organizing implementation of decisions made by the Participant and the Board of Directors.

14.3.5. Preparation and submission to the Board of Directors of the Company's performance reports.

14.3.6. Approval of internal procedures, instructions, and regulations developed in accordance with the Company's policies as adopted by the Company's Board of Directors.

14.3.7. Decision-making on accepting by the Company of property of the borrowers (pledgers) as payment for microcredit arrears, and on disposing of such property.

14.3.8. Decision-making on extending microcredits in situations provided for by the Company's policies and procedures, and making decisions on other matters delegated by the Board of Directors to the Management Board.

14.3.6. Performance of other functions delegated by the Board of Directors and Participant.

14.4. The Management Board is headed up by the General Manager who is approved by the Participant for a two-year term.

14.5. The General Manager is authorized to:

14.5.1. Represent the Company's interests and act on behalf of the Company without a power of attorney.

14.5.2. Issue powers of attorney to represent the Company, including with the right to issue further powers of attorney.

14.5.3. Manage the day-to-day activities of the Company in accordance with this Charter.

14.5.4. Represent the Company in all institutions and organizations, including foreign.

14.5.5. Establish and terminate, on behalf of the Company, business relationships, conduct business meetings and negotiations, enter into agreements (contracts) on behalf of the Company within the scope of powers provided for in this Charter.

14.5.6. Enter into and terminate employment agreements with the Company's personnel.

14.5.7. Sign all financial documents of the Company, as well as statements, reports and balance sheets.

14.5.8. Issue orders binding upon all employees of the Company.

14.6. The General Manager and Chief Accountant are personally responsible for the reliability of accounting and financial statements of the Company.

14.7. The Management Board operates in accordance with the provisions of this Charter, internal documents of the Company and the legislation of the Kyrgyz Republic.

14.7. The procedure of calling and conducting scheduled and extraordinary meetings of the Management Board is set forth in the Company's normative documents.

14.8. The Management Board has a quorum for decision-making purposes if its meeting is attended by two out of three, or three out of four (five) current members of the Management Board. Decisions are made by a simple majority of votes. If the votes are split evenly the vote of the Company's General Manager is the decisive vote.

14.9. The Company's Participant may decide to terminate early the powers of any of the members of the Management Board or the entire Management Board.

15. ACCOUNTING AND FINANCIAL REPORTING

15.1. The Company maintains accounting of all transactions and expenses in accordance with the provisions of the legislation of the Kyrgyz Republic. All accounting documents of the Company are subject to inspection by the Company's Participant (or its authorized representative). The fiscal year of the Company commences on January 1 and ends on December 31. The first fiscal year begins upon government registration of the Company.

15.2. The Company is required to possess and keep the following documents:

15.2.1. Information about the full name, details, and legal address of the Participant, the full names and postal addresses of each member of the Company's Board of Directors and Management Board.

15.2.2. The Participant's decisions to increase the Authorized Capital, to make any additional contributions, as well as documents confirming actual performance of the Participant's obligations.

15.2.3. Notices served by the Company to the Participant regarding the timeframe to form the Authorized Capital of the Company.

- 15.2.4. Copies of this Charter and all amendments and additions to it.
- 15.2.5. Decisions by the Participant with respect to the activities of the Company, records of Board of Directors and Management Board meetings.
- 15.2.6. Financial statements of the Company for every fiscal year.
- 15.2.7. Other mandatory documents pertaining to the Company's activities required by the legislation of the Kyrgyz Republic.
- 15.3. The safety of the Company's documents is the responsibility of the General Manager.
- 15.4. The Company is required, within 90 days of the end of every reporting year, to submit to the Participant a statement containing information about the Company's activities during the relevant year. Such statements must be prepared in accordance with the International Accounting Standards and must include, but not be limited to the accounting balance sheet, a profit-and-loss statement, a cash flow statement accompanied by additional information upon the request of the Board of Directors.
- 15.5. The General Manager is required to provide to the Participant consolidated financial information about the Company's activities within 15 days of the end of every month. All submitted reports are in addition to and do not replace other documents provided to the Participant under this Charter.
- 15.6. The Board of Directors approves banks where the Company's funds are to be kept.

16. AUDITS

- 16.1. An Internal Auditor appointed by the Participant monitors the Company's financial and economic activities.
- 16.2. The Internal Auditor conducts audits of the Company's financial activities, ensures reliability of accounts and the effectiveness of the internal controls system in accordance with the legislation of the Kyrgyz Republic.
- 16.3. The Internal Auditor is responsible for performing responsibilities entrusted upon him in accordance with the agreement (contract) made with him and the provisions of the legislation of the Kyrgyz Republic.
- 16.4. Annually the Company is required to have its financial and economic activities based on the year's results audited by an External Independent Auditor.
- 16.5. The External Independent Auditor of the Company is authorized to require the Company's officers to provide documents on the financial and economic activities of the Company.
- 16.6. An extraordinary external audit of the Company may also be conducted by an independent professional auditor upon decision of the Management Board, Board of Directors or at the request of the Participant.
- 16.7. The Company is required to annually submit to the National Bank of the Kyrgyz Republic one copy or a duplicate of the full report of the External Auditor without any changes (the management's report and financial statements) within 30 days of the External Auditor submitting the report to the Company.

17. REORGANIZATION OR LIQUIDATION OF THE COMPANY

- 17.1. The Company may be reorganized (via merger, affiliation, division, spinning-off, or transformation) or liquidated upon decision of the Participant or, in situations provided for by the legislation of the Kyrgyz Republic, in accordance with procedures established in this Charter and the legislation of the Kyrgyz Republic.

17.2. As a result of the Company's reorganization, all of its rights and responsibilities convey to its legal successor(s).

17.3. In the process of reorganization, the Company transfers all documents, including those pertaining to the management, financial and economic activities, and employees to its legal successors in accordance with the procedures established in the legislation of the Kyrgyz Republic.

17.4. The liquidation of the Company is performed by a liquidation commission appointed by the Participant in accordance with this Charter and the legislation of the Kyrgyz Republic, and, in the event of court-ordered liquidation, by a court-appointed liquidation commission.

In the event of liquidation, the Company is required to surrender the original licenses and/or certificate to the National Bank of the Kyrgyz Republic within three days of the making of the liquidation decision and to discontinue operations provided for in the license immediately once the decision to liquidate is made.

17.5. The Company terminates activities and is liquidated in any of the following events (each constituting a "liquidation event"), depending on which one of them occurs sooner:

17.5.1. A written decision of the Participant;

17.5.2. Effectiveness of a judgment to liquidate the Company under the laws of the Kyrgyz Republic;

17.5.3. Other circumstances provided for by the legislation of the Kyrgyz Republic.

17.6. Upon the occurrence of any liquidation event, the liquidation commission continues to manage the Company's assets at the expense of the Company and has all the rights and responsibilities vested in its governing bodies. The liquidation commission takes steps it deems necessary or appropriate for proper termination of the activities of the Company and final distribution of its assets in the manner provided for in this Charter and in accordance with the legislation of the Kyrgyz Republic, and also takes the following steps, including but not limited to:

17.6.1. Ensures proper accounting for the assets, liabilities and transactions of the Company until the final liquidation of the Company;

17.6.2. Organizes an external audit of the Company's financial and economic activities as of the commencing date of the Company's liquidation in order to identify the Company's assets and liabilities.

17.6.3. Pays, satisfies or settles, from the Company's funds, all of the Company's debts and liabilities (including, without limitation, all expenses incurred during liquidation).

17.6.4. Transfers to the Participant property left after the claims of the Company's creditors have been satisfied.

17.7. In the event of the Company's liquidation, the liquidation commission submits to the registering agency a liquidation balance sheet, based on which an appropriate entry is made in the government register of legal persons to the effect that the Company's activities have been terminated.

17.8. Liquidation is considered complete and the Company is considered to have terminated its activities upon the making of the relevant entry in the government register of legal persons.

17.9. Upon termination of its activities, the Company's documents are transferred for safe-keeping to the National Archives of the Kyrgyz Republic in accordance with the legislation of the Kyrgyz Republic.

18. FINAL PROVISIONS

18.1. This Charter takes effect upon government registration of the Company and remains in effect until a new version of the Charter has been adopted in accordance with the legislation of the Kyrgyz Republic.

18.2. This Charter is made in the Russian language in three copies, each vested with identical legal force.

On behalf of the Participant
