Savings and Credit Union Development Project

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FINAL REPORT

Implementation Period May 2002 through July 2009

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List of Acronyms

ADB	Asian Development Bank
AGM	Annual General Meeting of Credit Union Members or CUA Members
ATM	Automated Teller Machine
CBU	Central Bank of Uzbekistan
CUA	Credit Union Association
FSDA	Financial Sector Development Agency
GOU	Government of Uzbekistan
IFC	International Finance Corporation (World Bank Group)
IT	Information Technology
PEARLS	WOCCU’s Financial performance monitoring system
POS	Point of Sale (Service)
RFP	Request for Proposals
SCU or CU	Credit Union
SCUDO	Savings and Credit Unions Development Organization (formerly CUA)
US$ or $	United States Dollar
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions, Inc.

I. **Executive Summary**

To promote economic and community development, no other sector is more important than an effective, well-capitalized, financial system which mobilizes domestic savings. In Uzbekistan, the low level of financial deepening could not be fully addressed by bank restructuring. There was a demand for new financial institutions (non-bank financial institutions) that are owned and operated by the members of the community, and thereby more responsive to community needs. Specifically, there was a demand for a financial institution that can supply a complete set of financial services to meet the effective demand of its clients, that extends its outreach and focus to the local community, allows more thorough and aggressive supervision and regulation, meets the legal and regulatory prudential requirements, protects savings and replaces external funds with savings as the most important source of liquidity for continued growth. Credit Unions were found as the most appropriate form of non-bank financial institutions meeting all these characteristics and capable to effectively deliver financial services to underserved population.

WOCCU has been involved in the development of the credit unions in Uzbekistan since 1999. For Uzbekistan credit unions were absolutely a new type of non-bank financial institutions. WOCCU brought in international expertise to provide assistance in each stage of the development. Since 1999 to 2002 WOCCU, with ADB funding, has contributed to the development of a legislative base, in the development of the "On Credit Unions Law", that was adopted in April of 2002. Starting from 2002 WOCCU has developed the credit union movement with funding from United States Agency for International Development (USAID).

Over the life of the project, the project had four different stages: (i) development/ creation of the new credit union movement, that was directed to determine the feasibility of savings and credit union (SCU) operations in rural areas of Uzbekistan, through the founding of three pilot SCUs in the regions of Namangan, Bukhara and Samarkand; (ii) establishment and operation of institutionally and financially sustainable credit unions' network that included the intensive technical assistance to all licensed credit unions and initiative groups and improvement of the legislative base to ensure the system's safety and soundness; (iii) development of the second-tier organization for the credit unions' network, Savings and Credit Union Development Organization (SCUDO, formerly Credit Union Association) and its services to the associated credit unions, with its two core competencies- Model Credit Union Building Program (MCUB) and Deposit Insurance therefore creating the self-regulated system based on the increased operational and safety requirements for participating credit unions; and, (iv) expansion of the SCUDO services supporting the credit unions by establishment of a Virtual Private Network (VPN) to provide data exchange services and introduce new products and services unavailable without efficient and secure data exchange mechanisms.

The objectives of the first stage have been successfully achieved and lessons learned from this stage have been used as the background to modify and adjust MCUB methodology further implemented in 29 credit unions in Uzbekistan. In the first two stages the project delivered intensive technical assistance to the partner credit unions that included development of all internal operational policies and procedures, on-site trainings and monitoring of results, formal classroom trainings, and small grants assistance directed to build the credit unions' technical infrastructure and cover start-up operational costs. About 105 formal trainings have been conducted for more than 2,900 credit unions' executive staff and elected officials, and more than 180 on-site visits have been made in order to check credit unions' compliance with the standards and monitor the results.

In the third stage, the project supported the CUA that was founded at the initiative of the project and its two core competences- Model Credit Union Building Program and Deposit Insurance. Based on WOCCU's continuing evaluation and development of its MCUB program implementation, there was a need for greater efficiency and cost effectiveness. CUA has implemented a modified WOCCU Model Credit Union Building Program, with technical capacity building provided by WOCCU. This modified methodology required significant counterpart contributions from the partner credit union, both in terms of human and financial resource contributions and was able to identify, in a short period of time, the willingness and commitment of the credit unions to move towards the goal of becoming a CUA credit union.

One of the main project's success was the establishment and development of the CUA deposit insurance (guarantee) fund (DIF), which aligns the incentives and authority to regulate, and makes insurance protection financially credible through unlimited mutual liability (cross-guarantee/ coinsurance) among CUA credit unions. The CUA DIF is based on the self-regulated internal system build by CUA internal policies and procedures and contracts with participating credit unions. The key to the successful implementation of the CUA DIF was the enforcement of ethical integrity, and the establishment of the necessary accountability between the CUA and its member credit unions.

The successful implementation of the project objectives and the significant input from the CUA associated credit unions allowed this second tier credit union organization to become fully operationally and financially sustainable within three years since its registration. Additionally, it was successful in accumulating the professional technical staff capable to effectively monitor the credit unions' financial position and provide training and consulting services as well as all allow the CUA to protect the interests of the associated credit unions and lobby for the legislative and normative changes therefore creating the favorable environment for the safe and sound credit unions' development.

As of June 30, 2009 the CUA had 12 member credit unions receiving deposit guarantee from the CUA that represent the largest and the most stable credit unions in Uzbekistan and 13 partner credit unions that received the CUA technical assistance services in order to achieve the minimum compliance criteria to become the full-right CUA members. As of June 30, 2009 total membership number of the 25 member and partner credit unions reached 67,975 and total assets have achieved almost US$ 49.5 million those representing almost 48% of the whole credit union's system.

While in the fourth stage of the project USAID and WOCCU have agreed on the implementation of centralized data exchange and data clearing project, some of the major assumptions put as the basis for these objectives were found as unreasonable during the preparation stage. After discussing the results WOCCU jointly with the Credit Union Association and associated credit unions have agreed that introduction of such services is premature as it would require much larger investments and longer timeframes than was initially planned as the estimated volume of operations is insufficient to achieve the financial sustainability within next six years. With this in mind in early June 2009 the project management from WOCCU/ Madison has decided to close down the project.

Implementation of the USAID funded Credit Union Development Program has brought to existence credit union network made up of 91 credit unions. After almost seven years since the first credit union was licensed in Uzbekistan the emerging system is comprised of financial cooperatives representing the whole spectrum – big and small, serving communities and professional groups, specializing in consumer lending and providing primarily small business loans, fully automated and those largely relying on simple spreadsheets to perform accounting and reporting.

As was initially planned under the project exit strategy the Credit Union Association has become the full steward of the "best practices" accumulated by the project and in March 2009 also became full-right member of the World Council of Credit Unions, thus integrating into the world credit union movement and maintaining the access to the best international expertise.

II. Project Background

To promote economic and community development, no other sector is more important than an effective, well-capitalized, financial system which mobilizes domestic savings. Although numerous and intensive reform efforts were underway, Uzbekistan's banking system did not fully support broad-based private sector economic growth. Private savings as a percentage of gross domestic product (or national income) was less than 10 percent (2001). The limited financial deepening, noted in the case of Uzbekistan, could be attributed to the following factors: (i) small number of alternative types of financial institutions; (ii) a difficult macroeconomic environment; (iii) low public confidence in existing banks; and (iv) the absence of appropriate legislation and regulation for non-bank financial institutions.

Uzbekistan's banks had a limited capacity to supply a complete set of financial services to rural communities—in a survey of 600 rural households in Khorezm, Samarkand and Namangan regions, 82 percent of respondents indicated that they did not use banks for their private savings, and less than one percent received a bank loan during the year 2000[1]. Banks could generally be characterized as suppliers of directed credit to targeted sectors in response to their significant needs. Yet, flows of funds, even to the targeted groups, were constrained by four factors: (i) bank credit policies required that businesses be incorporated or legally registered; (ii) bank managers were liable for non-performing loans, making them perhaps excessively conservative in their lending decisions; (iii) banks have been unable to mobilize domestic (community) savings because of the legal/policy environment that constrains available loan capital and limits outreach and growth; and (iv) bank credit programs were strangled by institutional and operational policies and procedures that impact their efficiency and competitiveness. The net effect to rural communities was the absence of access to formal financial services. This impeded the broader goal of increasing economic growth and creating jobs[2].

Uzbekistan's banks and their directed credit programs had a narrow impact on broad community development. The level of community development was a manifestation of an important, underlying problem; capital was systematically drained from the community or could not be effectively mobilized, and concurrently intermediated, because of the lack of confidence in the financial system and the redlining of capital investment outside of the community. Consider that Narodny Bank, "the People's Bank", was the most important depository financial institution in Uzbekistan and had a loan to deposit ratio of 0.07[3]. In effect, banks and directed credit programs were not sufficiently responsive to the community's financial service needs. Community wealth was not made available for community use, homes continued to go un-repaired, and businesses and households continue to lack access to the capital they need to start-up and expand income generation activities. Equally important, consumer demand was not being supported with access to financial services, without which businesses cannot profitably exist.

The low level of financial deepening could not be fully addressed by bank restructuring. There was a demand for new financial institutions (non-bank financial institutions) that are owned and operated by the members of the community, and thereby more responsive to community needs. Specifically, there was a demand for a financial institution that can supply a complete set of financial services to meet the effective demand of its clients, that extended its outreach and focus to the local community, permited more thorough and aggressive supervision and regulation, met the legal and regulatory prudential requirements, protected savings and replaces external funds with

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[1] The survey was performed on behalf of PPTA-3254 UZB by the Tashkent City Center for Humanitarian Researches, in December 2000.

[2] According to the Food and Agricultural Advisory Policy Unit of the European Union (FAAPU) study, financial requirements by farmers are 65 billion soum (approximately $540 million). Assuming that farmers can access other forms of financing (20% of requirements), this indicates a credit demand of 50 billion soum ($417 million). The banks are estimated to have available nine billion soum ($75 million). The difference, $342 million, represents the financing gap.

[3] Source: Central Bank of Uzbekistan.

savings as the most important source of liquidity for continued growth. Savings and credit unions (SCUs) have been found to be second only to banks in lending and especially in providing deposit services to low-income clients, including women (World Bank 1996). The success of SCUs stems from real advantages they have over other providers of financial services to marginalized clients, including women. These advantages are associated with the following characteristics of savings and credit unions: (i) a diverse client base, (ii) informational advantages due to community foundations, (iii) the ability to provide simple, accessible deposit and loan services, and (iv) the capacity to lend to self-employed clients and obtain satisfactory repayment performance. Credit unions were particularly well suited to supply financial services in thin markets that existed in the rural areas of Uzbekistan. This function was becoming more important as the public sector banks are restructured, and possibly privatized, which would in the short- and medium-term further reduce the limited rural household access to financial services, as experience has shown in other countries that were going through transition (Balkans, Baltics and Caucasus).

Original Cooperative Agreement (beginning June 1, 2002 ending May 31, 2003)

The Rural Savings and Credit Union Development Project funded by United States Agency for International Development (USAID), US$ 460,000, was proposed as co-financing of the Asian Development Bank's (ADB) Pilot testing of Rural Savings and Credit Unions Project (TA-3635 UZB), amounting to US$150,000.

The Pilot Testing of Savings and Credit Unions (TA 3635-UZB) project was proposed to determine the feasibility of savings and credit union (SCU) operations in rural areas of Uzbekistan, through the founding of three pilot SCUs in the regions of Namangan, Bukhara and Samarkand. Establishment of SCUs in the country is expected to broaden and deepen the financial markets. A viable credit union movement would provide stable, democratic, and market-oriented financial intermediation that would contribute to micro enterprise promotion and poverty reduction. Results of the pilot project would serve as a guide for the establishment of SCUs all over the country. In addition, ADB and the Government of Uzbekistan (GOU) intended to tap 20 licensed SCUs to implement a subcomponent of the government's ADB-funded Small and Medium Development Facility (SMDF) that was expected to start in 2003. Technical assistance provided by the project would improve the capacity of SCUs to participate in the SMDF program.

The purpose of the combination of USAID and ADB funds was (i) to properly test the savings and credit union model that is being proposed in the loan project expected to be funded by ADB, as well as (ii) to determine the effectiveness of SCU legislation and regulations, policies and procedures, and supervisory arrangements prepared during the ADB's TA No. 3254-UZB, Rural Financing Savings and Credit Unions.

The project was rationalized with the SCUs' ability to offer the financial services that are necessary for SME growth, as well as member-owned, democratically –driven financial institutions SCUs would serve a locally implemented model of increased citizen participation. Therefore the project should contribute towards USAID's strategic objectives on accelerating the development and growth of private enterprise and increasing citizens' participation in political and economic decision- making.

As part of the "step-by-step" approach, the Government of Uzbekistan (GOU) agreed and worked with WOCCU, supported by ADB funding, to develop savings and credit union legislation and regulations. After this first step had been completed with adoption of the special Law "On Credit Unions", the next step was to operationalize pilot credit unions by providing initial training and education to the various players – GOU officials, SCU technical specialists, SCU members, and the communities served by SCUs. This pilot period provided to the GOU, pilot SCUs, WOCCU, USAID, and ADB a unique opportunity to test and correct, if needed, the laws and regulations, the operational policies and procedures, and the supervisory arrangements.

The project had two funding sources. An ADB budget of US$150,000 was to cover the cost of short-term international and local consultants to provide technical training for the three pilot SCUs; and the United States Agency for International Development (USAID) funding of US$463,256 was to help attain the goals of the pilot project. The USAID budget supported a more intensive technical assistance regimen with an expatriate project director, full time local staff, development grants, project operating costs, and indirect costs.

Cooperative Agreement Modification #1 (increase of the total estimated budget, modification of program description, period extension through May 31, 2006)

It was agreed that it is critical for the future safety of existing credit unions and sustainable growth of credit union system in Uzbekistan to continue technical assistance with the objective to develop a self-sustainable credit union system in the Republic of Uzbekistan. In 2003 USAID modified the Award Agreement and extended it through May of 2006. The Modification included the following substantial changes: (i) total estimated budget was increased by $2,298,262 therefore increasing the total budget up to $2,758,262; (ii) the project period was extended through May 31, 2006; (iii) the program description was modified in accordance with the information presented below.

The project represented a scaling-up of the ADB/ USAID funded Pilot Savings and Credit Union project. The Project was expected to support the establishment of at least 12 SCUs nation wide in the main oblast capitals with a total membership of more than 40,000 members by the end of the Project implementation period (year three). It was projected that this membership would collectively mobilize more than 3 million members, and the network of SCUs would have an outstanding loan portfolio of greater than $5 million at the end of the Project year three.

The project was rationalized with essence of an effective, well-capitalized, financial system that mobilizes domestic savings for the economic and community development. And although numerous reforms were underway the banking system in Uzbekistan did not fully support broad-based private sector economic growth and access to financial services is still limited especially in rural communities, particular to households, women and small businesses.

The project development goal was the improvement of rural community living conditions and the project objective was the establishment of an institutionally and financially sustainable network of SCUs.

The modified project had two components: (i) the establishment of a rural savings and credit union (SCU) system; and (ii) project implementation. It was expected that the ADB Loan Project—The Small and Microfinance Development Project (SMDP)—would provide a rural credit facility $2 million equivalent to supply subordinated debt to 20 SCUs. The Project would finance the establishment and operation of a Project Implementation Unit (PIU). A Savings and Credit Union Development Organization/Association (SCUDO) would be established as a key component of WOCCU’s exit strategy, if there is an effective demand for its establishment, through financial and technical support, as a non-commercial non-government organization, as a fee based provider of financial services and training to the SCUs. Under the project implementation arrangements it was agreed that a PIU would be established and transitioned to a market based, financially sustainable, non-commercial non-government organization—SCUDO—if there is an effective demand for its establishment. SCUDO would be established as a fee based provider of financial service and training, to SCUs. On other hand, the SSB in CBU would be responsible for the regulation and supervision of individual SCUs and the ADB Loan Project would provide SCUs with access to a line of credit.

The Projects non-quantifiable benefits would include: (i) the development of a modern financial savings and credit system in semi-urban areas with points of service that extend the outreach and benefits to the more isolated rural communities; (ii) increased competition in the provision of semi-urban and rural financial services to promote efficiency of service delivery; (iii) the establishment of an independent, market based organization to act as a service provider to SCUs; and (iv) the creation of SSB within CBU for the regulation and supervision of SCUs.

Cooperative Agreement Modification #4 (increase of the total estimated budget, modification of program description)

Another modification was made to the Agreement in September of 2004, increasing number of project partner CUs from 12 to 20, thus allowing all licensed credit unions in Uzbekistan to apply for participation in the project. The Modification included the following substantial changes: (i) total estimated budget was increased by $720,333 therefore increasing the total budget up to $3,478,595; (ii) the program description was modified in accordance with the information presented below.

The Project represented an expansion of the USAID funded Rural Savings and Credit Union development Project (Uzbekistan). As of June 30, 2004 the project had concluded written partnership agreements with 11 credit unions. However, total number of credit unions as of this date has reached 19 and expected to increase by 4-5 within the near future. Therefore under these circumstances project expanded its technical assistance and support to 20 savings and credit unions nationwide.

As an exit strategy, Project Implementation Unit (PIU) should be transitioned to a market-based, financially sustainable, non-commercial non-government organization – Savings and Credit Union Development Organization (SCUDO). SCUDO would be established as a fee-based provider of financial service and training to credit unions. Due to the poor quality of financial services provided by the commercial banking sector credit unions are currently being underserved (because of strategies used in implementing monetary policy and cash restrictions). It creates demand for services that could be met within the credit union system itself through SCUDO or organization alike (such as establishing inter-credit union liquidity channeling and handling mechanism and creating access to short term borrowing to address liquidity management issues). However, to ensure long-term sustainability of such venture the “quality control” component for credit unions and for the system as a whole had to be established. At that time the system was immature, credit union internal supervisory/ audit committees were weak and performance of external supervision (Central Bank) still required major improvements before individual operational and overall systemic risks could be reasonably controlled without outside assistance. Under these circumstances the project proposed to establish Special Action Team (SAT) that would perform the role of “internal auditor and supervisor” for the system. SAT was not intended to substitute for Central Bank’s supervision. It was expected that SAT would be assumed by the SCUDO before the project close-out and would continue to perform role of internal auditor for the system. Thereby assuring that SCUDO would be perfectly positioned to fill current gaps and provide both – quality demand driven fee based services and compliance enforcement with International Financial and Operational Performance Standards introduced by the Project.

Cooperative Agreement Modification #6 (increase of the total estimated budget, modification of program description, extension of the project period through September 30, 2007)

The third substantial modification to the project occurred in September of 2005 with USAID providing additional funding, expanding project scope and increasing term of Agreement till September of 2007. The Modification included the following substantial changes: (i) the total estimated budget was increased by $794,227 therefore increasing the total budget up to $4,272,822; (ii) the program description was modified in accordance with the information presented below; (iii) the project period was extended through September 30, 2007.

The purpose of the extension was to support the development of the SCUDO and its two core competences- Model Credit Union Building Program (MCUB) and Deposit Insurance. The following would be pursued: 1) to implement a modified MCUB program and methodology with new strategies to make it more efficient and allow more potential credit unions to affiliate to the SCUDO; 2) to structure the SCUDO MCUB to be financially sustainable without cross subsidies; and 3) to establish and develop the SCUDO deposit insurance fund, such that it aligns the incentives and authority to regulate and makes insurance protection financially credible through unlimited mutual liability (cross- guarantee/ co-insurance) among SCUDO credit unions.

Credit union system development requires a movement away from its "unit banking" model that is widely prevalent in developing countries. The "unit banking" model traditionally comes with the stereotypical 2nd tier organization, typically an association with "open" entry providing for representation and other services that are limited in both scale, scope and quality. The SCUDO Model is based on unlimited "branch banking" combined with a privately administered formal insurance program1 that involves the principles of self-regulation and unlimited mutual liability. The unlimited mutual liability provides the incentive to regulate and enforce in a timely and proper manner. Each credit union is considered as a "branch" of the SCUDO, is separate and distinct, and autonomous in its operations. The branch banking model shares the important common features of collective self regulation and incentive compatible inter-credit union monitoring that ensures that credit unions could protect each other without creating perverse incentives for member credit unions to take on excessive risks. Given the Central Bank of Uzbekistan's (CBU) lack of capacity, both from a human resource and material perspective, this additional layer of supervision is necessary. Furthermore, SCUDO incentives are linked to financial performance in contrast to CBU's incentives that are contaminated with political influence.

The physical proximity of member credit unions would enhance inter-credit union monitoring. Member credit unions would invest in inter-credit union monitoring because their fortunes are interrelated, and because the size of the coalitions is small enough that the benefits to an individual credit union from monitoring/regulating (which are shared) do not exceed the costs (which are private). Furthermore, this network of credit unions can credibly "coinsure" against shocks to the system; the credit unions as a group have agreed to bear the risk of any individual credit union's default; so long as members/depositors are confident of the solvency of the group, they would have no incentive to withdraw their funds. The SCUDO would also restructure financially distressed credit unions as means to increase SCUDO growth, and at the same further minimize risk, through a "next generation" model credit union building program (MCUB) to support start-up credit unions (given availability of financial resources). And the SCUDO would be able to take advantage of economies of scale—have fixed operating costs spread over a larger membership base and/or asset size reduces the marginal costs of supplying financial products and services—and potentially, economies of scope, and explore the supply of other financial services, e.g., remittances, credit and debit cards, etc. These activities and services form the framework of incentives necessary to keep SCUDO credit unions operating within prudential standards necessary for safety and soundness.

Cooperative Agreement Modification #8 (increase of the total estimated budget, modification of program description, extension of the project period through September 30, 2007)

The fourth substantial modification to the project with additional funding and extension of term till September 2008 was approved by USAID in September 2006 with the new objectives of setting up "deposit guarantee scheme" and introduction of the agricultural equipment leasing program in credit unions. The modification included the following substantial changes: (i) total estimated budget was increased by $1,388,778 therefore increasing the total budget up to $5,661,000; (ii) the program description was modified in accordance with the information presented below; (iii) the project period was extended through September 30, 2008.

WOCCU recognized that agricultural finance is an under-served market in Uzbekistan that presented a market opportunity for credit unions that are making in-roads in the mobilization of rural savings and are become increasingly significant players in the formal financial market (as of June30, 2006 total savings and shares mobilized by credit unions reached US$8.6 million; this is strong evidence of the trust of the rural population in financial cooperatives).

Yet, for credit unions to become significant players in agricultural lending, two issues must be dealt with: a) long- term financing; and b) collateral and contract enforcement. Long-term finance for agriculture in Uzbekistan remains very problematic.

During implementation of the Uzbekistan *Rural Savings and Credit Union Development Program*, the regulatory environment has undergone several changes, the most major in that the Credit Union Law has been amended to give more powers to the Central Bank, introduced new regulations governing the opening of branch offices, cash operations and movement towards new accounting regulations. New legal and regulatory requirements combined with stricter enforcement guidelines and procedures from the regulator required some qualitative change in operational processes in the credit unions, namely – changes in banking software program used by all project credit unions. This also required retraining of accounting staff and management, strengthening the capacity of Credit Union Association (CUA) to perform internal audit for the system, developing fraud audit procedures in order to safely provide liquidity management services for credit unions along with other financial services provided through CUA.

Cooperative Agreement Modification #9 (modification of program description, extension of the project period through September 30, 2010)

Last modification to the project with no additional funding and extension of term until September 2010 occurred in September 2008 with new objectives of: continuing to strengthen the credit union system through supporting the Credit Union Association and its member credit unions in designing, introducing and developing data exchange network and launching data exchange services and to create secure data exchange system enabling to connect credit unions among themselves and with the banks and merchants and introduce new technology based services. The Modification included the following substantial changes: (i) the program description was modified in accordance with the information presented below; (ii) the project period was extended through September 30, 2010.

Statistics among CUA's member credit unions indicated that 94% of all credit union transactions with their members are performed in cash and only 6% account for payment system transactions. While up until this point credit unions have left non-cash transactions market largely unexplored, the policy and communications technology investment trends by other market participants suggest that significant growth in such transactions should be expected in the periods to come and thus provides an opportunity for the CUs to consolidate their efforts to penetrate into the non-cash transactions market before it becomes highly saturated.

Establishment of data exchange network providing an opportunity for all credit unions to integrate into one system require certain pre-conditions for the project to be successful. Among others, there has to exist a core group of larger well operating credit unions able and willing to invest in a project that has a relatively long-term payback period of initial investment. Country of operation must have reasonable communications infrastructure accessible in remote areas. Due to the high cost of start-up and maintenance the data exchange network's participants must be able to generate critical mass of transactions to keep transactional cost at acceptable level, legal and regulatory environment must be sufficiently developed to ensure confidentiality and protection of members, accounts and transactions databases.

The credit union system, and the financial system in general, in Uzbekistan will need more time to embark on the establishment of a private data exchange network which employs modern technologies and provides opportunities for faster expansion of the service points (POS) and branches, increasing the range and quality of services and cutting down transactional costs in the future.

III. Project Goals and Objectives

Phase 1: June 2002- May 2003

The goal of the ADB' *Pilot Testing of Rural Savings and Credit Unions Project* was to develop a nationwide savings and credit union system for Uzbekistan. The purpose was to pilot test up to three SCUs, determine the effectiveness of SCU legislation and regulations, policies and procedures, and supervisory arrangements.

The primary outputs of the USAID co-financing project were the establishment and development of up to three pilot SCUs, and a report on the main issues and problems encountered during the implementation of *Pilot Testing of Rural Savings and Credit Unions Project.* The Report should be incorporated into the proposed ADB supported *Rural Savings and Credit Unions Loan Project* document. Other key outputs should include technical materials and a study tour report. In addition:

1. Ten trainings, covering approximately 50 days, conducted in Tashkent involving up to 90 SCU board members, staff and community leaders.
2. Implementation of WOCCU's in-site training program at the SCUS level will involve more than 50% of project staff's time.

The long-term specific outputs were planned as follows:

1. Professionalize pilot SCU management – institutionalize (implement and make functional) an assets/ liability and funds/ liquidity management program, together with the PEARLS financial management and Business Planning System, and the Loan Portfolio Analysis Tool (LPAT).
2. Implement an SCU accounting system that meets International Accounting Standards (IAS), e.g. loan loss provisioning, loan portfolio valuation and treatment of interest accruals.
3. Increase the membership at each SCU to 500 members at the end of year one, 1,000 members by the end of year two, and 2,000 members by the end of year three. Total membership is 1,500 year one, 3,000 year two, and 6,000 year three.
4. Mobilize total savings and shares by year-end among the three SCUs of US$ 45,000 year one, US$ 150,000 year two, and US$ 396,000 year three.
5. The total loans outstanding by the end of year one are expected to be US$ 210,000 for the 3 pilot SCUs. By the end of year three, total loans outstanding are projected to be more than US$ 600,000.
6. SCUs will meet the following financial performance targets that help ensure that the SCU members' savings and shares mobilized, as well as donated capital (USAID and ADB), are protected in safe and sound SCUs:
   - ❖ Delinquency of 5% or less;
   - ❖ 100% provision for loan losses 1 to 12 months;
   - ❖ Net capital adequacy of 7% by the end of year two, and growing to greater than 8% by the end of year three; and
   - ❖ Positive net income by year two, and net income sufficient to increase net capital adequacy to greater than 8% by the end of year three.

Phase 2: June 2003- May 2006

The primary purpose of the project in the Stage Two for the projected period through May 2006 was the establishment and operation of an institutionally and financially sustainable, safe and sound network of SCUs. The project represented a scaling-up from the ADB/USAID funded *Pilot Savings and Credit Union Project*.

The project scope involved the establishment of rural SCUs, and potentially, depending upon SCU effective demand, a Savings and Credit Union Development Organization/Association (SCUDO).

The project's targeted and measurable objectives were as follows:

1) Establish a SCU network that is financially safe and sound, institutionally sustainable and moving towards the following prudential standards:

    a. 100 percent provisions for loan losses delinquent by more than one year;
    b. 35 percent provisions for loans delinquent less than 12 months;
    c. Operating expenses/average assets < 5 percent;
    d. Net income/average assets sufficient to maintain an institutional capital ratio of 10 percent or more;
    e. Return to member shares > inflation rates;
    f. Delinquency rate (outstanding balance of loans delinquent) > 30 days < 5 percent;
    g. Membership growth > 100 percent per year for the first four years;
    h. Asset growth > inflation rate;
    i. Liquidity reserve/withdrawable savings and deposits = 10 percent;
    j. Institutional capital (or "risk capital")/total assets > 10 percent;
    k. Net loans/total assets = 70-80 percent; and
    l. Deposits/total assets = 70-80 percent.

2) Develop the SCU management and staff capability to a level that can effectively run a "modern" SCU with total assets in excess of $1 million.

3) Expand project SCU's outreach to and beyond oblast capitals by supplying remunerative financial services that meet effective demand from the field of membership:

WOCCU's accountability on the quantitative targeted objectives to USAID/CAR are summarized in the below table:

Indicators	SSTA—On-going	Year 3
Number of SCUs	3	12
Total Membership	2,000	40,000
Total Assets	$346,191	$6.3 million
Total Loans Outstanding	$246,480	$5.3 million
Total Savings and Shares	$78,000	$2.3 million
Institutional Capital	$68,191	$677,539
Total External Credit	$200,000	$3.2 million
Members to Total Households	0.05%	0.9%

With the approval of Modification #4 to the Cooperative Agreement the quantitative and qualitative indicators have been reviewed and modified. The below table:

Quantitative targets	Without access to ADB Subordinated Debt	Including funds available through ADB SMD Program
Number of partner CUs	20	20
Total Membership	40,000	40,000
Total Assets	$7,487,000	$8,987,000
Total Savings	$4,920,000	$4,920,000
Total Loans	$6,425,000	$7,925,000

Qualitative targets	
Credit Union service points	Up to 48
Women members	No less than 25%
Average loan size	No less than $260
Average savings size	No less than $60
Provisions against loan losses	To fully cover the risk
Operating expenses	10% or less of average assets
Profitability/ Net Income	Sufficient to maintain institutional capital at the level of 10% of total assets
Dividend payment	More than inflation
Loan delinquency (PAR)	No more than 5%
Membership growth	Sufficient to meet membership targets
Annual asset growth	More than inflation
Institutional capital	No less than 10% of total assets

Phase 3: September 2005- September 2008

The broad development goal of the project extension was to establish, in effect, a "private" legislative framework and deposit insurance through further strengthening of the SCUDO. The SCUDO represents a paradigm shift away from the "unit banking" model of credit unions with its accompanying 2nd tier organization to the "branch-banking" model.

The project's components address the proper structure of private deposit insurance with attention on strengthening the SCUDO through increased membership, additional financial services supply, and its regulatory body. WOCCU will transfer the Project's MCUB technical program to SCUDO, and establish a deposit insurance facility and regulatory body that is a subsidiary of the SCUDO with a board of directors that is comprised of a majority of independent directors.

The ultimate success of the SCUDO will depend on its ability to achieve operational and financial sustainability without continued external subsidy. In order for this to happen, WOCCU's goals are:

1) Create a private legislative framework with prudential standards that all affiliated members must follow;
2) Transfer a revised MCUB technical assistance program to SCUDO to resolve deficiencies—cost effectiveness—in the current project;
3) Strengthen the SCUDO by establishing the following:
    a. Deposit Insurance Facility (including a Financial Stabilization Fund); and
    b. Additional Financial Services, e.g. International Remittances, legal counsel, and technical services.
4) Consolidated credit union targets:

Targets	September 30, 2006	September 30, 2007
Membership	50,000	100,000

Total Savings and Shares	$11.5 million	$21.5 million
Total Net Loans outstanding	$10.5 million	$20 million
Total Assets	$13 million	$24 million

In 2006 adding the agricultural leasing product piloting in the selected credit unions and implementation of new accounting software has expanded the project objectives.

Agricultural equipment leasing through credit unions is an innovative program to further deepen Uzbekistan's rural financial markets. Agricultural equipment leasing through credit unions is a strategic intervention to provide long-term agricultural finance without the typical collateral and contract enforcement problems. Agricultural equipment leasing is a valuable addition to credit unions' menu of products and services.

The project's development goal is to further deepen Uzbekistan's rural financial markets.

The project's objectives are:

1) Determination of the effective demand for agricultural equipment leasing;

2) Research and development into an agricultural equipment leasing program for credit unions;

3) Implementation of an agricultural equipment leasing program in up to 4 credit unions;

4) Total leasing outstanding of US$ 500 thousand of agricultural equipment;

5) Total value of leasing supplied/disbursed up to US$ 750 thousand;

6) Delinquency of less than 10 percent on leasing portfolio; and

7) Earning a positive net income from leasing products/services.

8) Development of fraud audit procedures and training of Association's Examiners on how to perform fraud audit.

9) Implementation of a new Credit Union Accounting Software Program in at least 20 credit unions.

10) Consolidated credit unions targets:

Targets	**September 30, 2007**	**September 30, 2008**
Membership	100,000	125,000
Total savings and shares	$21.5 million	$27 million
Total net loans outstanding	$20 million	$26 million
Total assets	$24 million	$32 million
Average loan size	$1,200	$1,280
# of loans outstanding	16 700	20 300
Loans outstanding	$21 million	$27.5 million
Loans disbursed (for a year)	$22.8 million	$34.5 million
Delinquency	Max. 10%	Max. 10%
# of female borrowers	Not less than 25%	Not less than 25%

11) Financial targets for an agricultural equipment leasing program:

Targets	September 30, 2007	September 30, 2008
Average lease value	$2 000	$2 000
# of leases outstanding	250	250
Leases outstanding	$500 thousand	$500 thousand
Leases disbursed (for a year)	$550 thousand	$200 thousand
Delinquency	Max. 10%	Max. 10%
# of female lessees	Not less than 25%	Not less than 25%

Phase 4: October 2008- September 2010

Overall project objective at the last stage was to continue strengthening of the credit union system through supporting Credit Union Association and its member credit unions in designing, introducing and developing data exchange network and launching data exchange services accessible to all licensed credit unions to enable credit unions to create service points and branches at a lower cost for better outreach and mobilization of new members and to create secure data exchange system enabling to connect credit unions among themselves and with the banks and merchants and introduce new technology based services.

Goals of the project extension are to add value to the current Credit Union Association's services already available to member and partner credit unions and create access to new technology based products:

i) Centralized data exchange and data clearing services offering credit unions to connect their remote service points and proposed branches with the home office accounting departments thus decreasing the cost of providing services in locations remote from headquarters offices and geographically expanding credit union's own service networks;

ii) Centralized data exchange and data clearing services linking credit unions with merchants and bank payment clearing centers allowing participating credit union members to pay for goods and services at the points of sale through newly offered credit lines, overdrafts on member savings accounts and other loan products available only by employing modern communication technologies;

iii) Data clearing services between participating credit unions enabling to serve members at any credit union linked in the network, regardless of their physical location, and effectively creating a mechanism where each participating credit union can serve as a branch of any other participant thus increasing number of service points for their members without a need for additional cost to open a fully fledged branch;

iv) Data exchange network(s) linking credit unions with other service organizations (credit bureaus, mobile phone companies, etc.) vital for further increase of the safety, quality and price of CU services, expansion of outreach and improvement of the efficiency, e.g. credit history exchange, internet- banking, sms-banking.

Expected outcomes at the end of the extension period were planned as follow:

1) Establishment of a Virtual Private Network (VPN) under the auspices of the Credit Union Association providing data exchange services to Uzbek credit unions and introducing new products and services unavailable without efficient and secure data exchange mechanisms;

2) New products and services offered to their members by the participating credit unions resulting from joining the VPN, including, but not limited to payments for goods and services in non-cash form at the points of sale made available through introduction of VPN,

access to credit union members to services in other participating credit unions via shared branching arrangements, credit rating queries;

3) Introduction and operation of at least 25 Point of Sales (POS) devices in credit unions and their branches supplied through the VPN;

4) Introduction and operation of at least 15 POSs at the merchant locations supplied through the VPN;

5) Annual membership growth of at least 60% in the participating credit unions;

6) Annual savings growth of at least 60% in the participating credit unions;

7) Annual loan growth of at lest 60% in participating credit unions;

8) At least 20 credit unions using services of VPN.

PMP Targets Table:

#	Targets	Baseline Data 9/30/08	10/1/08-9/30/09	10/1/09 – 9/30/10	Project Total
1a	Number of POS devices installed in credit unions and their branches	0	8	17	25
1b	Number of POS devices installed with merchants	0	7	8	15
2a	Number of transactions with merchants processed	0	2,000	38,000	40,000
2b	Number of “shared branching” transactions processed	0	1,500	18,500	20,000
3	Number of credit information queries processed	0	600	4,400	5,000
4	Total number of participating credit unions	0	6	14	20
5	Membership of participating credit unions	23,000	37,000	60,000	60,000
6a	Total Savings of participating credit unions	$16 million	$27 million	$55 million	$55 million
6b	Total Net Loans Outstanding of participating credit unions	$19 million	$30 million	$63 million	$63 million
6c	Total Assets of participating credit unions	$22 million	$32 million	$67 million	$67 million

IV. Project Implementation Methodology

The project implementation consisted of 4 main stages:

a. Development/ creation of new credit union movement
b. Establishment and operation of institutionally and financially sustainable credit unions' network
c. Development of the second-tier organization for the credit unions' network, Savings and Credit Union Development Organization (SCUDO, formerly Credit Union Association) and its services to the associated credit unions.
d. Establishment of a Virtual Private Network (VPN) under the auspices of the Credit Union Association providing data exchange services to Uzbek credit unions and introducing new products and services unavailable without efficient and secure data exchange mechanisms.

A. WOCCU's methodology for the creation of new credit unions included test piloting of three credit unions and clearly separated credit union's organizing and operational stage.
After selection of the geographical areas for and sponsoring groups for the pilot credit unions that was based on the surveys conducted under the PPTA and the selection criteria agreed upon between CBU, WOCCU and ADB the project followed with technical programs for credit unions, regulatory agency officials and staff. The goal of the technical training programs was to have everyone both knowledgeable and comfortable with their assignments taking special emphasis on the development of credit unions' official and staff financial and accounting skills, and on the implementation of sound internal controls.

The organization and start-up of pilot credit unions included the following components:

a. Management plan- even the identified organizers/ sponsors for the pilot credit unions had the skills to carry out organizing campaigns they had very limited technical capacity to financially manage the credit unions. Through the special training programs the project developed the financial management skills for the elected officials and managers of the credit unions.
b. Resources- that was the major concern for the start-up credit unions and required infusion of grant funds to the pilot SCUs. The needs for resources for the credit union start-up were defined as following: (i) technical training; (ii) start-up capital; (iii) large, dense population; (iv) affordable facilities; (v) organizing costs; and (vi) volunteers.
c. WOCCU provided intensive on- and off-site technical trainings/ consulting to address management plan requirements such as: credit union start-up and organizing technical programs; accounting technical training programs; supervision committee technical training programs; credit committee technical training programs; board of directors and manager technical training program; supervision and examination technical training program; review and recommendations: credit union legislation, regulations and model bylaws.

B. The establishment and operation of institutionally and financially sustainable credit unions' network was implemented through organization and staffing the Project Implementation Unit (PIU). The PIU was responsible for providing technical assistance, training, and on-site technical support for the implementation of the technical programs to Project credit unions' board of directors, management, staff and membership.

The Project used an integrated approach of technical assistance, training, and direct on-site execution to implement the restructuring and consolidation programs. This process was comprised of the following steps:

1. Participation Agreement —Business Plan. Developing the business plan was the most demanding and difficult technical aspect of the SCU start-up process and quality operational process. WOCCU facilitated the drafting of the business plan, working with the SCU

organizers and potential manager. WOCCU's main role was to keep the organizers on track so that they reach their goals in a timely fashion. The business plans were drafted after the results of a pledge survey have been analyzed. The business plan helped to build the union between the ideas, goals, and objectives of the potential SCU and the financial projections. The financial projections aimed to determine if the formation of the SCU is feasible, and for the already formed SCUs what need to be changed in order to increase the efficiency and bring the operations in compliance with the established standards. The financial qualitative and quantitative projections were included as the targets for the partnership agreements concluded with participating credit unions and/or initiatives groups.

2. Implementation: Technical assistance, Training and Direct On-Site Support and Execution of Technical Components. Delivery of technical assistance was based on the creation of demand for internal compliance assessment in CU network in addition to CBU's regulatory/ supervisory actions thus creating initial basis for development of SCUDO. Expanded trainings, including classroom, on-site and off-site trainings, have been provided to all credit unions' employees and elected officials on all aspects of credit union's operations and CBU regulations. The project has instituted the special certification program for CU staff and elected officials. Based on the lessons learned from the first stage of the project the grant funds provided to partner credit unions was redefined using the concept and split it into 3 components: i) purchase of equipment, office improvement, purchase of licensed accounting software; ii) operating subsidy (start-up) only; iii) revolving deposit/ loan to the best performing CUs (in the absence of ADB credit line or other source of external funding). The project also has developed the special marketing strategy for the each partner credit unions and implemented marketing programs for products, membership, initiative groups and project.

3. Monitoring and Evaluation: The project MOU with the partner credit unions specifically outlined financial performance standards and growth targets that must be met to maintain partnership status and clearly outlined confidentially of data that project consultants had to access in order to provide high-quality consulting. The PIU assumed the role of internal auditor for the CU networks to assist CBU in controlling systematic risk. The project partner credit unions were enforced to meet financial disciplines through on-site monitoring, grant incentives, training to all elected officials, separation of policymaking and executive functions.

C. The development of the second-tier organization for the credit unions' network, Savings and Credit Union Development Organization (SCUDO, formerly Credit Union Association) and its services to the associated credit unions was targeted to: 1) implement a Modified Credit Union Building Program (MCUB) and methodology with new strategies to make it more efficient and allow more potential credit unions to affiliate to the SCUDO; 2) structure the SCUDO MCUB to be financially sustainable without cross subsidies; and 3) establish and develop the SCUDO deposit insurance fund, such that it aligns the incentives and authority to regulate and makes insurance protection financially credible through unlimited mutual liability (cross-guarantee/ co-insurance) among SCUDO credit unions. The project has supported the SCUDO and its two core competences- Model Credit Union Building Program and Deposit Insurance.

Based on WOCCU's continuing evaluation and development of its MCUB program implementation, there was a need for greater efficiency and cost effectiveness. SCUDO had to implement a modified WOCCU Model Credit Union Building Program, with technical capacity building provided by WOCCU.

During the final phase of the previous project stage (through June 2006), WOCCU designed and executed a "fast track" methodology to streamline and accelerate the implementation of all MCUB programs, methodologies, and tools for new credit union partners in Uzbekistan. This fast track methodology required significant counterpart contributions from the credit union partners, both in terms of human and financial resource contributions, as well as decisive management and board actions to set in motion key policy reforms through the PEARLS/Business Planning software that is available to all project participants and further SCUDO associated credit unions (i.e., delinquency control, loan loss provisions, institutional capital creation, operating expense controls, etc.). The key to successful implementation of the fast track methodology allow to determine in a short period of time, the willingness and commitment of the board of directors and management to move as quickly as possible towards the goal of becoming a SCUDO credit union.

One of the keys to the project's success was to establish and develop the SCUDO DIF, such that, it aligns the incentives and authority to regulate, and makes insurance protection financially credible through unlimited mutual liability (cross-guarantee/ coinsurance) among SCUDO credit unions. The SCUDO DIF design is a function of Uzbekistan's information, contracting and legislative environment. For the SCUDO DIF to operate fairly and efficiently in Uzbekistan, where information and the enforcement of ethical integrity are often low, the process between WOCCU and SCUDO has been open enough to establish the necessary accountability between the SCUDO and its member credit unions.

The objectives of the SCUDO DIF are:
1) Guaranteeing all, or part, of a member's deposits against loss through a payment made directly by SCUDO DIF to a depositor when a credit union is unable to do so.
2) Providing financial assistance through grants/loans to restore distressed credit unions to a minimum capital level and/or render it solvent.

The strategic fundamentals of the SCUDO DIF that promote long-term sustainability are:
1) Right for further assessment—cross guarantees where all SCUDO credit unions are liable for each other's commitments;
2) Requirement for credit unions to make capital contributions in the form of long-term deposits that are subordinate to other liabilities, and therefore, by definition represent subordinated debt;
3) Right for the SCUDO DIF to do the following: take administrative actions, issue cease and desist orders, assume a conservatorship of a credit union, and terminate a credit union's access to the SCUDO DIF.

The SCUDO DIF represents a multidimensional program that will balance the costs and benefits through rulemaking and enforcement. Specifically, the SCUDO DIF will protect credit union members and service users from being blindsided by credit union insolvencies through the following actions:
1) Limit aggressive risk-taking by credit unions;
2) Prevent and control damage from credit union runs;
3) Detect and resolve insolvent and distressed (damaged) credit unions; and
4) Allocate resources across credit unions whatever losses occur when an insolvent credit union is closed.

Summary of SCUDO DIF Activities

Activities	**Objectives**
Gathering financial information, analyzing and monitoring financial performance indicators (e.g., PEARLS)	• evaluate the level of risk as evidenced by the credit union's performance • identify emerging problems
Prescribing and promoting standards of sound business and financial practices as a condition of	• ensure that member credit unions are adopting practices to minimize the size and frequency of

membership	claims on the SCUDO DIF
Conducting on-site examinations	• evaluate adherence to sound business and financial practices and assess the adequacy of action plans to resolve weaknesses
Establishing criteria for the purpose of intervention	• follow a systematic approach in managing the risk of claims to the SCUDO DIF
Intervening in the affairs of credit unions	• ensure that credit unions are developing and implementing action plans to rectify unsound financial or operational trends

Since October 2006 the project has expanded support to the SCUDO in two other directions, namely:
• Implementation of agricultural equipment leasing program in credit unions
• Development of fraud audit procedures and training of Association's Examiners on how to perform fraud audit
• Implementation of a new Credit Union Accounting Software Program in at least 20 credit unions.

WOCCU approaches the agricultural equipment lease market as a business proposition. The project, CUA and participating credit unions viewed serving this market as a successful business proposition, not an act of charity or subsidy. The project was aimed to, at a minimum, break even in the Agricultural Equipment Leasing Program. WOCCU was working through CUA (SCUDO), an existing Uzbekistan legal entity, so that in the event the project closes down before September 30th, 2008, the program will not close down, but will continue to operate through CUA. At that WOCCU had a position on the CUA board of directors that required unanimous Board approval for changes in key CUA policies and procedures.

The project, CUA and participating credit unions participated in the implementation of a direct agricultural equipment leasing program. The project had to conduct the research and development component of the program. The credit unions, together with the project and CUA, would set the loan rates, market the program, and underwrite and fund the leases.

The criteria for credit unions to access the Agricultural Leasing Program were:

1) Operations of credit union must be in compliance with norms and requirements of the current legislation and normative acts of the Central Bank.
2) Credit union's rating in accordance with the Association Regulation "On evaluation of financial sustainability of credit union and compliance with requirements established for Association's permanent members and provision of access to the Stabilization Fund" must be 1, 2 or 3. In addition credit unions must operate for more than one year and maintain appropriate rating for at least 3 months prior to submission of application for the Association's permanent membership.
3) Credit union must meet all economical norms established by the Central Bank for credit unions.
4) Credit union must follow the requirements and conditions set in the Association's foundation documents and internal regulations.
5) Credit Union must participate in the Fund operation and fulfill all conditions set in the Association's Regulation on Stabilization Fund.
6) Credit Union must conclude and fulfill conditions of Membership Agreement.
7) Credit union must implement general operational standards in accordance with Association's Regulation On credit unions' operational standards.
8) Credit union must ensure transparency and accuracy of accounting in accordance with the Central Bank requirements and national accounting standards.
9) Credit union must submit periodic reports and other information on its operation to Association in the format and by dates specified in the Association's Regulation On Internal Reporting System.
10) Credit union must have appropriate automated accounting system allowing complying with all requirements to reporting and accounting.

Summary of actions required to implement the agricultural equipment leasing program:

1) Selection of participating Credit Unions;
2) Market research and determination of effective demand;
3) Assessment of agricultural equipment suppliers and their conditions;
4) Assessment of risks related to leased equipment and potential lessees;
5) Development of leasing procedures;
6) Selection and training of CU loan officers on lease underwriting, monitoring and collection;
7) Launching agricultural equipment leasing products in participating CUs.

The project was responsible for implementation of the Accounting Software Upgrade and the Fraud Audit Program.

Current software used by the credit unions had to be replaced with a locally developed product that was being adopted and tested in one of the partner credit unions. The new product meets local accounting requirements and has a sufficient capacity to perform daily accruals on loans and savings accounts and perform loans and savings interest calculations according to locally used methodologies, has an option to perform loan schedule adjustments based on nonstandard loan repayments, will have a capacity to support branch operations on-line as well as will have required reporting capacity to produce required reports to both—the regulator and the management and will ensure full compliance with local accounting and reporting requirements on a long term basis. It also significantly improved quality and efficiency of accounting and reporting processes in the credit unions. Complete automation of accounting and performing daily accruals of interest is mandatory requirement by Central Bank regulation and internal procedures of the deposit guarantee scheme. The implementation of the new accounting software was based on the cost share with participating credit unions. The project has funded the new accounting software installation and CUs paid for all the necessary computer hardware to operate newly developed software as cost share to this automation component. That was necessary in order to ensure higher probability and faster process of credit unions in meeting requirements to become members of the CUA, and therefore enjoy the benefits of the mutual guarantee program that provides greater safety to the system and better protection for credit union savers.

Implementation of the Fraud Audit component involved the development of an early warning system for fraud detection based on financial reports, and the development of fraud audit procedures. CUA examiners were provided both on- and off-site training on fraud audits.

D. Establishment of a Virtual Private Network (VPN) under the auspices of the Credit Union Association providing data exchange services to Uzbek credit unions and introducing new products and services unavailable without efficient and secure data exchange mechanisms.

Due to the complexity of designing, introducing, testing and launching data exchange networks, implementation was planned to be done in stages, clearly segregating those where implementation of the next stage is dependant on completion of the previous one. Overall project implementation strategy presumed that WOCCU would implement the project in close co-operation with the CUA. WOCCU would provide technical assistance to the CUA and its VPN through its Representative Office. WOCCU would significantly downscale the operations of the country office compared to the current level and will maintain only one Managing/Technical Staff (Project Director at 100%) and 1.5 administrative staff (Office Manager at 100% and Security/Logistics Officer (driver) at 50%). WOCCU would also provide international technical consulting and management support to ensure smooth implementation of technology components of the project. Development and operations of the VPN were planned to be mostly done by CUA and participating credit unions under the oversight and technical assistance provided by WOCCU's in-country office. Such strategy was aimed to provide for a smooth exit at the end of the proposed extension period leaving CUA and its VPN with institutionalized procedures and processes and with qualified staff.

Implementation of each project component within the proposed strategy requires varied levels of technical assistance to be provided to CUA and its proposed VPN. Summary of the key steps and activities for implementation of each component are provided below. Scope and intensity of technical assistance provided to the CUA at each stage and for each component were to be negotiated and approved by the virtue of a written agreement at the start of implementing no-cost extension.

<u>Component -1. Establishing Virtual Private Network</u>. WOCCU planned to assist the CUA to design, set-up, test and launch the proposed VPN. The following preparatory work needed to be completed during the preparatory stage:

- Investigate legal, regulatory and taxation regimes to provide data exchange and informational settlement services by non-bank service organization. Recent legislative and regulatory acts on payment settlements using public telecommunications networks, electronic information storage and exchange, electronic payments, electronic documents, digital electronic signature and other relevant acts have formed reasonable legal basis for development and operation of VPN for purposes such as payment settlements. However, because information processing and clearance for payment settlements offered by non-banking service providers is a relatively new in Uzbekistan, it is important to obtain complete analysis and recommendations from lawyers prior to choosing further course of action.
- Perform market research on data exchange services through existing networks and assess volumes of payment settlements through currently available POS networks, assess potential effects of government's policies on demand for settlement of non-cash transactions involving natural persons and develop comprehensive business and marketing plan confirming reasonable probability to reach required transactional volumes within the VPN by the end of project extension period.
- Design architecture for the VPN network, investigate availability of the required equipment in local market and assess tax and customs regime for the required equipment if it is imported by the CUA. Choose communication providers for the VPN.
- Develop and approve bylaws, operating policies and procedures, governance principles, job descriptions, internal control mechanism, data security requirements and measures and contingency plans.
- Develop and approve detailed budget such to ensure sufficient cash flows and profitability within the reasonable period of time to sustain credit union interest to participate in the joint investment to launch VPN.
- Develop and sign agreements on investment in VPN with the CUs who have expressed and confirmed their interest in participating in the project.
- Hire and train executive and technical staff.
- Establish governance procedure and train the governing body.
- Procure and install computer equipment.
- Sign agreements with software providers to operate data exchange servers (hub or switch) and install software.
- Develop software interfaces between the hub and credit unions/branches to establish data encryption and data translation capability.
- Test correctness, completeness, quality, efficiency and security of data encryption, translation, transmission and storage.
- Launch data exchange services within the VPN.

Component 1 must be completed prior to starting implementation of components 2-5.

Component 2 - Data exchange with CU service points and/or branches and between participating credit unions themselves, creating shared branching network and new service points:

- Train CU staff in using POS terminals and provide technical assistance to participating CUs to open new branches/service points.
- Promote products and services among credit unions, monitor transactional volumes and introduction of new service points as per business plan.
- Expand number of service points and/or branches of participating CUs through installation of new POS in remote locations or providing mobile banking services.
- Promote shared branching services among members and increase transactional volumes through shared branches as per business plan.
- Monitor and promote increase of membership, savings and loans to meet planned growth targets.
- WOCCU provide higher level of intensity of technical assistance to CUs opening service points/branches in locations outside of towns and cities.
- Expansion of branch networks/service points to distant locations and rural areas as transactional volumes and demand for payment clearance increases and more merchants are brought into the system.

  Implementation of Component 2 can be done only after Component 1 is completed in full, but can be started and completed independent from Components 3, 4 and 5.

Component 3: Introducing new loan products for CU members facilitating non-cash settlement of payments with merchants.

- Agreements with the commercial bank(s) servicing CUs on payment settlements and negotiation of fees and commissions based on the transactional volumes.
- Agreements with the merchants on installation and operation of POSs owned by VPN, installation, interfacing and testing, launch of operations.
- Roll-out of CU products and services to settle transactions between members and merchants.
- Monitoring and increase of monthly transactional volumes to meet business plan targets.
- Potential partnerships with non-member CUs to join deposit guarantee scheme after meeting minim risk requirements.

Component 3 could be started only after Component 1 has been completed and Component 2 is operational. It can be implemented independently from Components 4 and 5.

Component 4: Introducing database of credit histories and developing other value added services:

- Development of platform for database management and information exchange
- Population of database with credit histories
- Development of credit rating methodology and rating of borrowers based on available credit information
- Signing of agreements on credit information exchange with other emerging credit bureaus (e.g. CBU's NIKKI database)
- Launch of credit bureau services and monitoring of information exchange volumes to meet business plan projections.

Component 4 can be implemented only after completion of Component 1 and once component 2 is operational. It is independent from implementation of Components 3 and 5.

Component 5: Providing CUA's Examination Department with read-only on-line access to credit union accounting systems.

- Create read-only on-line access to accounting and transactions data bases for better monitoring and consulting of insured credit unions.
- Interface hub software with the accounting (banking) packages of insured CUs
- Set access levels and internal control procedures to ensure safety of data and integrity of accounting systems

Component 5 can be implemented only after Component 1 is completed and Component 2 is operational. It is independent from Components 3 and 4.

V. Project Results vs. Objectives

Phase 1: June 2002- May 2003
Development/ creation of new credit union movement

The original project goal to establish three viable SCUs in Samarkand, Bukhara, and Namangan regions was exceeded by 67% when the project expanded its client base and helped establish 5 viable SCUs. By the end of the project, all the 5 project-assisted SCUs (3 pilots and 2 associates) had attained profitable levels of operations with healthy growth trends in their credit and savings portfolios.

The primary method by which WOCCU helps SCUs develop is through the conduct of technical workshops and conferences to build up the capabilities of SCU personnel, and to generate local interest and support for the credit union movement. From July 2002 to July 2003, the pilot project organized and conducted a total of 28 training events for SCU clients, key government officials, legislators, regulators, and interested citizens. Initially, the project depended heavily on foreign consultants brought in to share their expertise regarding credit union development. But reliance on foreign experts declined as more local staff were trained and exposed to MCUB methodology. In sum, the project provided 1,206 man-days of credit union related training within the past 12 months.

In addition to the formal training events mentioned above, the project also made many technical assistance visits to individual SCUs in the regions to conduct onsite inspection and evaluation, to provide specific training for SCU staff, to consult and advise on particular problems besetting individual SCUs, to review the progress of office improvement activities, and to develop professional work relationships with SCU staff. A total of 67 technical assistance visits were made to the various SCUs.

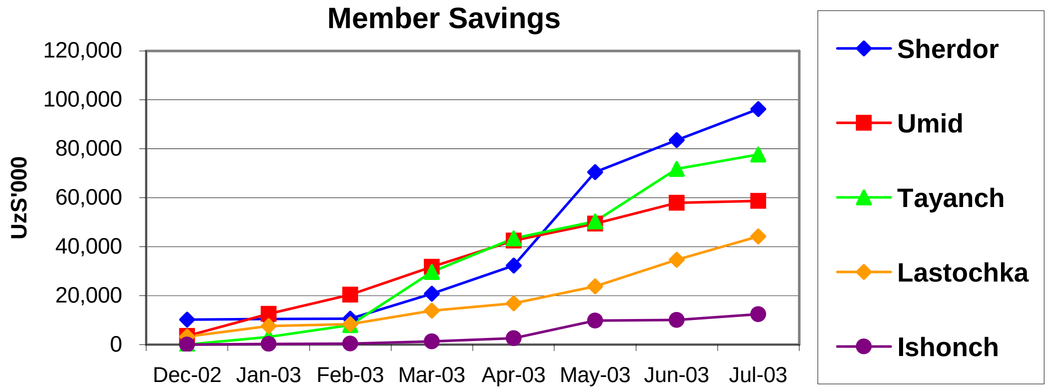
The starting membership sizes for the 5 project-assisted SCUs in Uzbekistan were quite large, averaging 560 members as of December 2002. The relatively large average membership of the SCUs was a reflection of two factors: 1) in order to qualify for project assistance, the SCUs were required to diversify their membership to represent different economic sectors of the local community; and 2) the minimum initial capital set by CBU at US$10,000 was comparatively high, making it necessary to have a big number of founding members to raise the funds if the membership was drawn from among ordinary people in the community.

NUMBER OF SCU MEMBERS

Month	Sherdor Samarkand	Umid Bukhara	Tayanch Namangan	Lastochka Navoi	Ishonch Jizzak	Total	Average
Dec-02	506	683	1,111	198	302	2,800	560
Jan-03	528	733	1,127	236	307	2,931	586
Feb-03	535	744	1,169	253	308	3,009	602
Mar-03	601	776	1,180	286	315	3,158	632
Apr-03	676	780	1,211	304	328	3,299	660
May-03	729	813	1,238	346	347	3,473	695
Jun-03	765	842	1,271	380	358	3,616	723
Jul-03	792	875	1,294	414	382	3,757	751

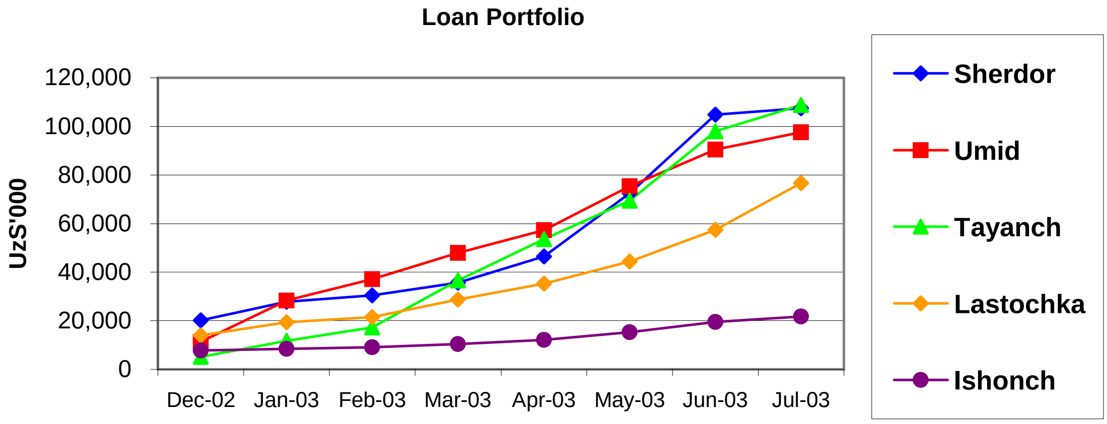
The 3 pilot SCUs (Samarkand, Bukhara, and Namangan) combined had 2,300 members by the end of CY2002, or 97.9% of the ADB performance target of 2,350. By July 2003, the 3 pilots had 2,961 members, already exceeding ADB's 2003 year-end target of 2,820. Compared to the extrapolated goal of 2,624 for July, they were 11.3% above target.
As anticipated, the SCUs found it extremely difficult to bring in member savings during their first two months due to a general lack of confidence in financial institutions. However, through persistent promotion, focusing on the distinctions between credit unions and other financial institutions, the SCUs succeeded in bringing in their first few depositors. It became apparent later that many members were simply waiting for others to take the lead.

By July 2003, the 3 pilot SCUs had attained average per capita savings of $78.52 from total savings of $232,495 (at a foreign exchange rate of 1,000 Soums per US Dollar). Actual per capita savings was more than 7 times the $10.58 ADB goal for July and 6 times the $12.67 target for the year-end. Total savings for the 3 pilots was 8 times the pro-rata ADB goal of $27,766 for July and almost 7 times the 2003 year-end goal of $35,100. A graph showing the actual savings growth curve for each SCU up to July 2003 is presented below.



The combined gross loan portfolio of the 3 pilot SCUs amounted to $317,966 as of July 2003, or 6.5 times the extrapolated ADB target for July 2003 of $48,372 and 5.7 times the 2003 year-end goal of $55,638. As explained earlier, the fast growth in the loan portfolio was made possible primarily because of successful savings mobilization. In addition, the pilot SCUs conserved most of the development grants they received by putting these into institutional capital for loans, rather than outright spending for startup costs.

In July 2003, the aggregate assets of the 3 pilot SCUs amounted to $411,315 and 80% of this was invested in their loan portfolios. The major fund sources of the pilot SCUs were as follows: 56% or $232,495 from member savings, 32% or $132,625 from net donations and grants, 7.4% or $30,487 from member shares, and 2.6% or $10,508 from YTD retained earnings. The early infusion of non-recurring donated institutional capital helped strengthen the SCUs form the start. In the long run, it will be mainly savings mobilization that will fuel SCU asset and loan portfolio growth.



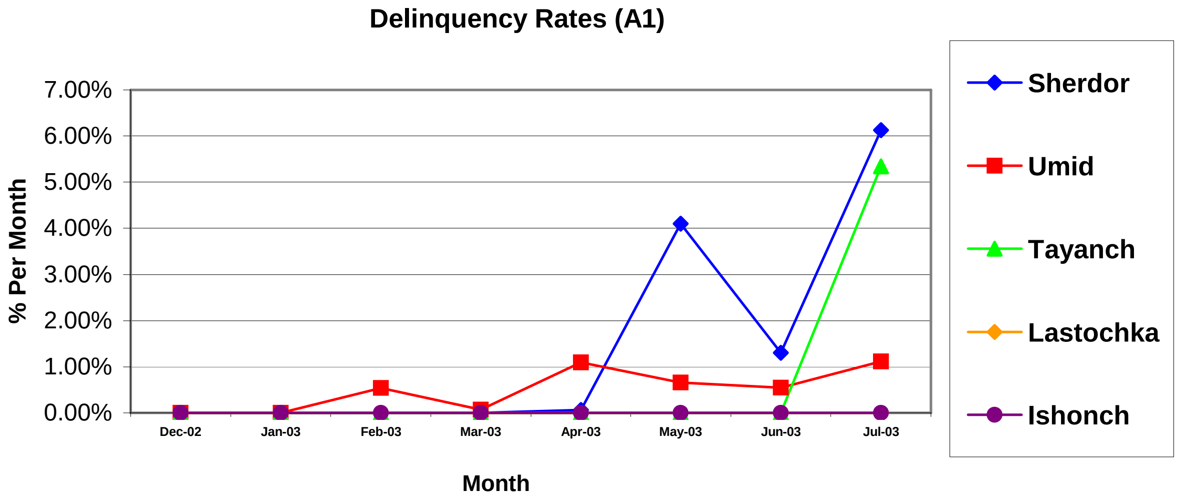
By July 2003, the 3 pilot SCUs provided $317,966 in micro loans to qualified members in their respective communities. Based on loan data provided by the SCUs, these micro loans had an average loan size of $588 and were distributed for various loan purposes, as follows:

Breakdown of Pilot SCU Micro Loans (July 2003)

Type of Loan	**% of Portfolio**	**Amount of Loans**	**Number of Loans**	**Average Loan Size**
Non-Commercial:				
Consumer	6.2%	19,626	71	276
Real Estate	3.6%	11,520	5	2,304
Other Non-Commercial Loans	5.4%	17,061	35	487
Total Non-Commercial Loans	15.2%	48,207	111	434
Commercial:				
Manufacturing	22.2%	70,702	83	852
Agriculture	39.5%	125,633	195	644
Transport and communications	0.0%	0	0	0
Trade and public food	16.1%	51,094	107	478
Technical suppliers and sale	1.5%	4,690	8	586
Home and utility services	0.3%	950	2	475
Other sectors	5.3%	16,720	35	478
Total Commercial Loans	84.8%	269,789	430	627
Grand Total	100.0%	317,996	541	588

Loan delinquencies comprise the biggest operating (credit) risk for SCUs, and much of the MCUB technology provided by WOCCU is aimed at preventing this problem. Most of the delinquencies experienced by the pilot SCUs up to July 2003, were the result of short delays in payments that were usually resolved and paid before the next collection cycle. In most cases, the delay in payment was caused by factors outside of the control of the borrowers.

In June 2003, the combined delinquency rate of the 3 pilot SCUs was at a 7-month peak of 4.31%, still within the WOCCU standard of less than 5%, however two of the three pilot SCUs were already above the 5% mark. The biggest delinquency came from member-borrowers of Sherdor SCU in Samarkand and Tayanch SCU in Namangan, who missed their scheduled payments this month.



Phase 2: June 2003- May 2006
Establishment and operation of institutionally and financially sustainable credit unions' network
The overall status of the quantitative and qualitative project objectives in this phase is demonstrated below as of June 30, 2006.

The Credit Union Development Project had assisted 29 credit unions licensed by the Central Bank of Uzbekistan by May 31, 2006 at various stages of their development. The direct technical assistance has been provided to the credit unions based on the partnership agreements. After the expiration of the last 16 partnership agreements between WOCCU and the credit unions on January 15, 2007 Association took over WOCCU's responsibilities on provision of technical assistance to all credit unions.

Establish up to 48 points of service (106% completed). Credit unions in Uzbekistan have had 29 head offices, six service points with permanent offices and 16 mobile field agents bringing total number of points of service to 51.

Ensure that more than 40,000 members will access financial services through credit union network by May 31, 2006 (100% completed). As of June 30, 2006 total number of members served by credit unions in Uzbekistan is 42,604.

Women will constitute at least 25% of membership (178% completed). Female members are 18,955 or 44.5% of total membership.

Total CU assets will be US$7.5M by May 31, 2006 (133% completed). As of June 30, 2006 total CU assets in Uzbek CU system were 10 million USD.

Total shares and savings will be US$4.9M by May 31, 2006 (176% completed). As of June 30, 2006 total shares and savings in CU system of Uzbekistan were 8.7 million USD (shares USD 1.7 million and savings USD 7.0 million).

Total gross loans will be almost US$6.4M by May 31, 2006 (135% completed). Total balance of net loans outstanding at the end of the Quarter 2, 2006 was USD 8.7 million.

Supporting further development of CU legal and regulatory framework and implementation of the supervision and examination program. In Quarter 2 2006 amendments to the Law on Credit Unions were signed by the President of Uzbekistan. Amended law was enacted on April 4, 2006. WOCCU and Uzbekistan Credit Union Association worked very closely with the Central Bank of Uzbekistan and Parliamentary Commissions in drafting the amendments. As a final result more than 90% per cent of all the amendments promoted by WOCCU and the Association were included in the law without any changes. Most importantly, among other improvements, new version of the law allows credit unions to open branch offices, provide financial leasing services and form credit committees from the employees of the credit union.

In May 2006 as a result of enforcement of new Credit Union Law the Central Bank of Uzbekistan issued a new regulation on licensing of credit unions in Uzbekistan. It was registered in Ministry of Justice and enforced in June 2006. Among other, the regulation has increased a minimum amount of share capital for credit unions from US$ 20,000 to US$ 50,000 for CUs registered in Tashkent and from US$ 10,000 to US$ 25,000 for those registered outside of Tashkent and set the qualitative requirements for the credit unions to open branches.
The project has regularly renewed and implemented the model operational policies for the credit unions, including lending policy, collection policy, savings policy, shares mobilization and

dividend payment, capital adequacy, non-earning assets, ALL policy, liquidity and ALM policy, and internal controls.

The project has also developed and implemented risk-rating system based on the PEARLS monitoring system. The purpose of the system is to evaluate the value and number of risks, and determine the risk-rating for the partner credit unions. The project has also implemented the examination program, including written on-site examination procedures. For the period from 2003 to 2006 the project has conducted about 115 on-site examinations of the credit unions.

Project will develop CU management capacity so that credit union managers are able to effectively manage CUs with over US$1M in assets. The project has delivered the trainings for the executive staff and elected officials on the on-going basis in such areas as: accounting, operational policies and procedures, lending and collection, savings mobilization, marketing, ALM, internal control.

For the period from 2003 to 2006 the project has conducted more than 75 trainings. Total of 1 720 people attended training programs.

Project will assist in qualification and access by project CUs to the subordinated debt provided by ADB to the credit unions. The project has made all possible efforts in development of the capacity of the credit unions to access the ADB subordinated debt. The special trainings programs have been delivered to the responsible government agencies, including Asaka Bank. The project staff also delivered the monitoring tools and trainings to Asaka Bank responsible staff, such as Pearls monitoring system, risk-rating system, model documentation to apply for the subordinated debt, model internal procedures for Asaka Bank on evaluation of the credit unions' financial condition and qualification for the debt.

Project CUs must be fully provisioned for all known and potential loan losses (completed 77%). As of June 30, 2006 loans delinquent more than 6 months were provisioned 100%, loans delinquent between 30 days and 6 months had provisions at the level of 77% of the CBU requirement.

CU Operating expenses to average assets should not exceed 10% (completed 120%). Consolidated operating expenses ratio as of June 30, 2006 was 8.35%.

Net income will be sufficient to maintain capital adequacy at a level of no less than 10% of total assets (completed 122%). Adjusted Return on Asset (ROA) for all of project partners at the end of the quarter was 7.54% and achieved projected target rate of 6.19%.

Dividend paid on member shares will be more than inflation. Dividends planned by project partners are at the rate of 25.7%.

Loan delinquency rate (portfolio at risk) will be less than 5% (completed 112%). As of June 30, 2006 adjusted consolidated delinquency ratio for all 17 project partner CUs was 4.45%.

Membership growth will be no less than 100% per annum (completed 42%). Consolidated annualized membership growth for second quarter of the year has been 42%.

Annual asset growth will be no less than 100% per year (completed 84%). On consolidated basis annualized asset growth for the second quarter of 2006 has been 84%.

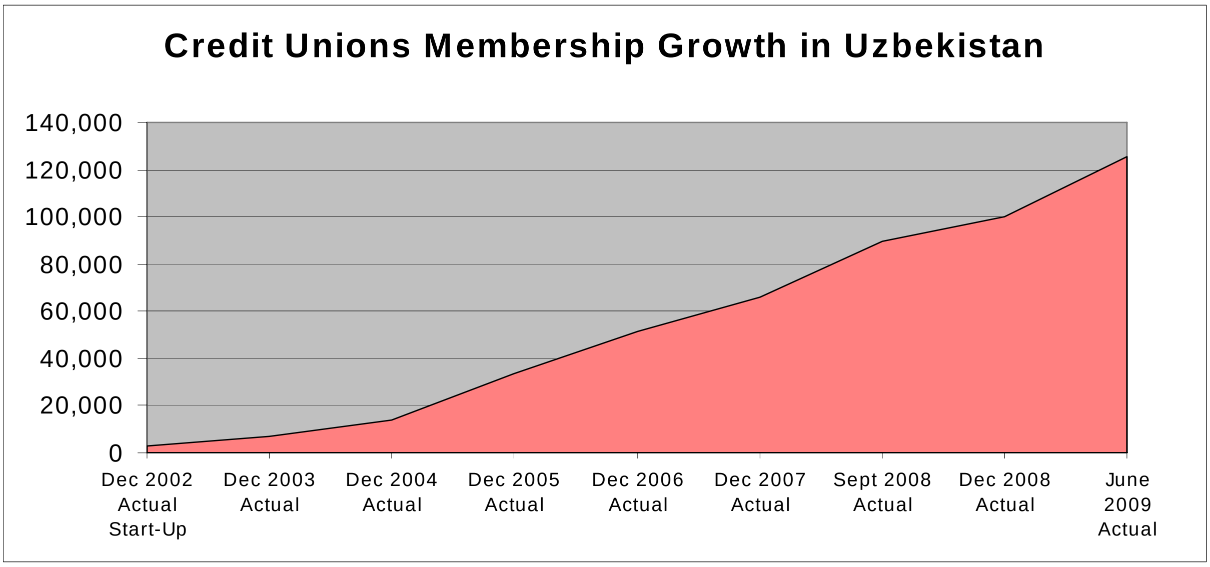
Institutional capital must be no less than 10% (completed 78%). Institutional capital ratio (adjusted) was 7.85 at the end of quarter 2, 2006.

Average loan size will be not less than $260. As of June 30, 2006 the average loan size was $1,174.

Average savings size will be not less than $60. As of June 30, 2006 the average savings size was $1,112.

Phase 3: September 2005- September 2008
The development of the second-tier organization for the credit unions' network, Savings and Credit Union Development Organization (SCUDO, formerly Credit Union Association) and its services to the associated credit unions

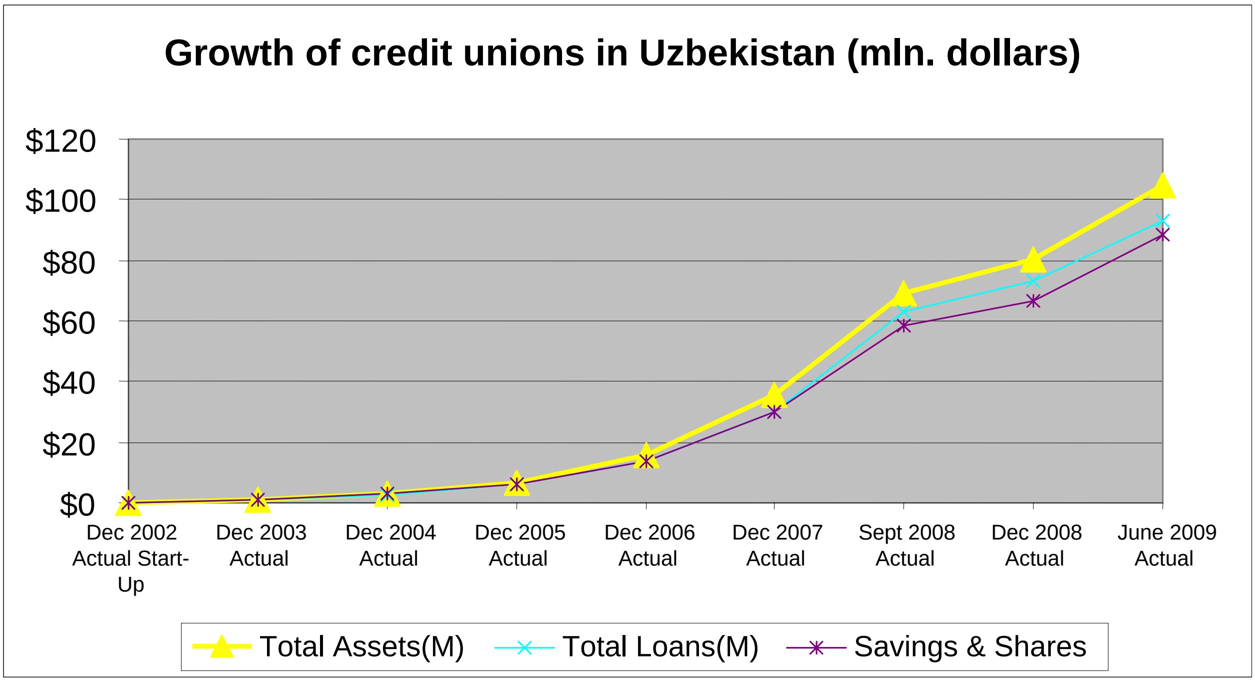
Ensure that more than 125,000 members will access financial services through credit union network by September 30, 2008 (71.4% completed). As of September 30, 2008 total number of members served by credit unions in Uzbekistan reached 89,300. Female members reached 37,400 (41,9% of total membership). Annualized credit union membership growth rate as of September 30, 2008 has been almost 50%.
The membership number as of June 30, 2009 has reached the target of 125,000 and totaled 125,122.



Total CU assets will be US$ 32M by September 30, 2008 (216% completed). As of September 30, 2008 total CU assets in Uzbek CU system were 69.2 million USD. Annualized total assets growth rate as of September 30, 2008 has been more than 180%.
As of June 30, 2009 the annual assets growth was above 60% and total assets reached 104.5 million USD.

Total shares and savings will be US$ 27M by September 30, 2008 (217% completed). As of September 30, 2008 total shares and savings in CU system of Uzbekistan were 58.65 million USD (shares USD 8.3 million and savings USD 50.4 million). Annualized growth rate of member shares and deposits as of September 30, 2008 has been more than 180%.
As of June 30, 2009 the annual growth of member savings and shares was above 64% and total amount reached more than 88 million USD.

Total net loans will be almost US$ 26M by September 30, 2008 (242.9% completed). Total balance of net loans outstanding as of September 30, 2008 was USD 63.2 million. Annualized growth rate of loan portfolio as of September 30, 2008 has been more than 183%.
As of June 30, 2009 the total net portfolio exceeded 93 million USD and annual growth rate was about 54%.



Assessment of Financial Performance of Project Credit Unions vs. WOCCU's International Credit Union Performance Standards:

The qualitative indicators for the CUA member credit unions have been derived at based on the financial reports after examination and adjustment by the CUA's examiners. The qualitative indicators for the partners have been checked off-site but were not adjusted. As of June 30, 2009 the CUA associated credit unions had the following qualitative indicators:

- For the CUA member credit unions loans delinquent more than 6 months are provisioned 100%, loans delinquent between 30 days and 6 months have provisions at the level of 102.58% of the CBU requirement. For the partner credit unions these ratios are 97.2% and 0% correspondingly.

- Consolidated operating expenses ratio of member CUs is 4.73%. This ratio for the partner credit unions is 6.15%. In general the operating efficiency has improved by 0.8% since the beginning of the year.

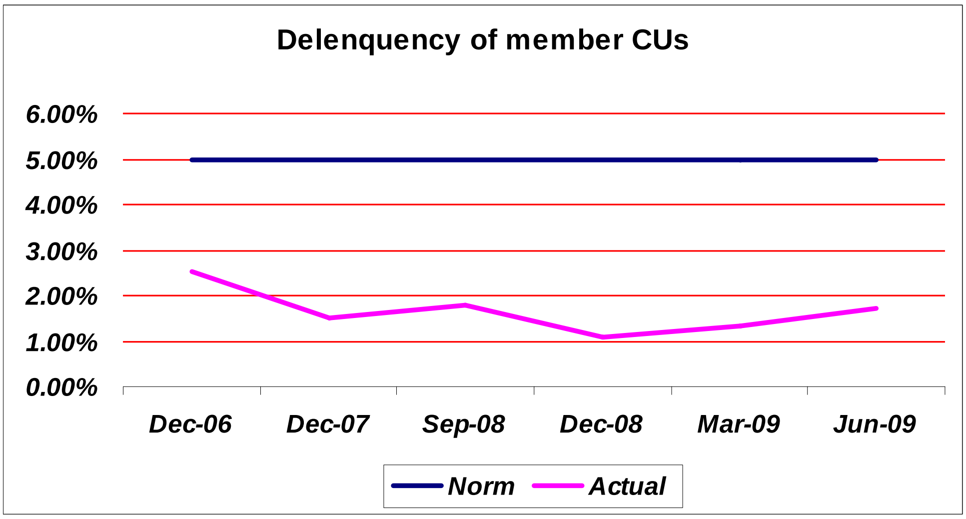
- Return on Assets for the CUA member credit unions (ROA has been adjusted for accrued dividends to be paid on shares for FY 2009) was 7.76% and has allowed to maintain institutional capital ratio at 13.64% of total assets. At the same time for the partner credit unions the ROA without adjustments for dividends is 4.10% that allowed building institutional capital ratio of 5.63%.

- Dividends for 2008 have been paid by member credit unions at the average rate of 50%. For year 2009 the average dividend rate accrued based on the business plans of member credit unions is 43.07%.

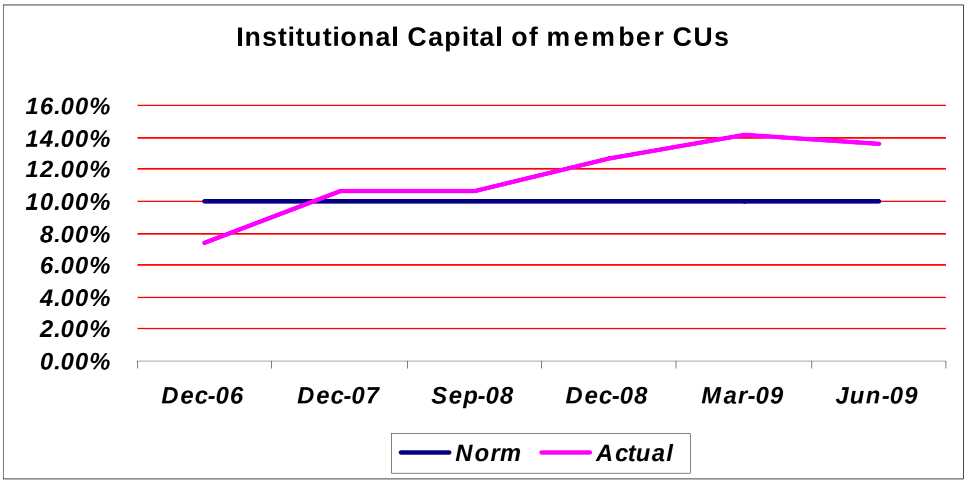
- Consolidated annualized membership growth for the member and partner credit unions has been 52.5%.

- Annual asset growth of member and partner CUs for Q2 2009 has been 50.34%.

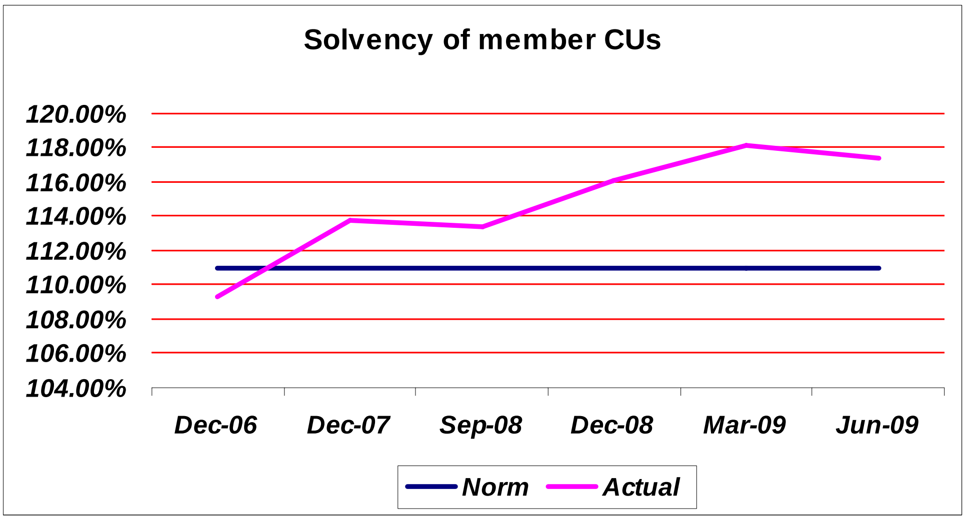
- Adjusted consolidated delinquency ratio for CUA members is 1.72%. For the partner credit unions this ratio is at the level of 4.82%.



- Institutional capital ratio (adjusted for dividends) for the member credit unions was 13.64%. For the partner credit unions this ratio (without adjustments for dividends) is 5.63%.



- Consolidated net worth of member credit unions calculated as total amount of shares and unimpaired reserves (adjusted for accrual of dividends) to earning assets totaled 24%.



Create a private legislative framework with prudential standards that all affiliated members must follow. Starting from July 2006 the project jointly with CUA started to develop/ modify the internal legislative framework by changing the CUA bylaws in order to establish the supportive financial services and deposit guarantee facility. With the assistance of international consultants the number of internal regulations have been developed and approved setting the framework with standards that all CUA affiliated credit unions have to follow. These regulations include:

- Procedures on acceptance of credit unions in Association membership
- Regulation on evaluation of credit union's financial condition with the purpose to identify its compliance for admission in permanent members and granting it with an access to the mutual guarantee system.
  - Attachment #1. Pearls monitoring system
  - Attachment #2. Risk rating system
- Procedures for resignation and expulsion of members from Association Board and Audit Committee
- Procedures for expulsion from Association membership
- Regulation On Association monitoring system of the member credit unions' performance, including:
  - Procedures on off-site monitoring;
  - Procedures on on-site monitoring of credit unions;
- Regulation On Stabilization Fund
- Regulation On minimal requirements to automated system of accounting and reporting for permanent members of Association
- Regulation on operational standards for member credit unions
- Regulation On confidentiality of information
- Regulation On Association Board
- Regulations on communication of Association member credit unions with Board and Executive departments of Association
- Regulation On unsafe and unsound credit unions practices

In addition the project has developed, tested and further transferred to the CUA the following tools that are used to monitor the risks and compliance of the affiliated credit unions:

- WOCCU's International Financial Performance Standards and Methodology;
- WOCCU's PEARLS system and credit union monitoring and financial analysis tool;
- Other automated financial analysis tools developed by the project
  - ALM- system allowing forecasting liquidity position and interest margin based on the projected cash flow and interest rate changes.
  - SCU Fin- software producing 24 different analytical reports based on credit union accounting data (e.g. breakdown of delinquency, distribution of savings and loans, weighted average interest rates on savings and loans, etc.)
  - "FinAnAdv 1.0" - software allowing to keep all current and historical financial data in one database, conduct comprehensive trend analysis of credit union operations and conduct red flag analysis of credit union reports
- WOCCU's PEARLS Risk Rating system;
- Off-site analysis procedures;
- On-site analysis procedures, including fraud audit procedures.
- Business plan preparation procedures (with monthly breakdown of targets)
- Credit union financial rehabilitation procedures (with preparation of rehabilitation action plan and financial plan)

The monitoring, analysis, and decision making process was segregated among CUA executive department and its selected officials (Board and general meeting) setting exact procedures of how revealed risks and deficiencies should be reviewed, analyzed and addressed. Since the origination of the CUA the WOCCU had one seat in its Board pushing for the compliance of the decision making process with the established written policies and bylaws.

To check the compliance of the participating credit unions with all legally established norms and mutually agreed safety and soundness standards the Audit Department was formed within the Credit Union Association. It was managed by the project under special Agreement between WOCCU and CUA until September 2008. It conducts on-site examinations and off-site analysis of the affiliated credit unions. Based on examination results CUA examiners jointly with managers of examined credit unions develop plans for corrective actions wherever such measures were deemed necessary. In addition, on monthly basis Audit department monitors financial condition and development trends of insured credit unions and provides recommendations for improvement, when necessary.

The CUA's Audit Department experts also provide on-going on-site and off-site consulting to all CUA affiliated credit unions. It distributes legislative updates that affect credit unions through postal and internet mail, assists CUs in preparation of policies and procedures, business plans and reports.

Comparative Table as of June 30, 2009

Indicators	All 91 Credit Unions'	12 CUA Member Credit Unions (Recipients of the Deposit Guarantee)	Percentage to the whole system	All (25) CUA Associated Credit Unions (Member and Partner CUs)	Percentage to the whole system
Number of Member-Clients:	125,122	43,570	34.82%	67,975	54.33%
Total Voluntary Savings:	$77.2 M	$24.3 M	31.50%	$37.2 M	48.20%
Total Shares:	$11.1 M	$2.3 M	20.72%	$3.9 M	35.14%
Total Loans Outstanding:	$93.02 M	$30.4 M	32.70%	$44.8 M	48.20%
Total Assets	$104.5 M	$33.33 M	32.00%	$49.5 M	47.40%

Transfer a revised WOCCU's International Financial Performance Methodology to the Association to improve cost effectiveness of the project. On July 12, 2006 the Project and the Association signed the agreement on joint activity in order to support achievement of strategic objectives of the Association and increase the efficiency of project implementation, namely:

- pool the resources, knowledge and experience available to contracting parties in order to achieve the overall Project objectives of supporting development of credit unions in Uzbekistan;
- ensure that credit unions comply with the laws of the Republic of Uzbekistan and with the regulations of the Central Bank of the Republic of Uzbekistan;
- support expansion and growth of credit unions in order to increase access to savings and loan services for the population of Uzbekistan, especially in rural areas,
- and, improve safety of savings portfolios and quality of loan portfolios of the credit unions through developing mechanisms of savings protection, inter credit union lending and collective risk control.

Based on the above agreement the Project and the Association have developed Joint Activity plan. According to the plan the following has been transferred by WOCCU to the Association:

- All project technical staff were transferred from the project to the Association;
- All training and certification programs developed by the project along with the responsibility to provide training either on full cost recovery basis or as part of membership fee paid by the credit unions;
- WOCCU's International Financial Performance Standards and Methodology;
- WOCCU's PEARLS system and credit union monitoring and financial analysis tool;
- Other automated financial analysis tools developed within the project (ALM, SCU Fin);
- WOCCU's PEARLS Risk Rating system;

Establishing Deposit Insurance Facility (including Financial Stabilization Fund). As per project plan Deposit Insurance Facility (Fund) consists of privately owned deposit guarantee scheme that is capitalized by the participating credit unions with refundable long-term investments and has contracted CU commitment for additional investments, if fund's capital is insufficient to cover the loss of guaranteed CUs. Key components safeguarding the Fund are Association's Audit Department and Stabilization Facility introduced with the objective of early detection of operational disturbances and increased risks along with the right for the Association to intervene in the operations of the distressed credit unions, apply sanctions and use Fund's resources on repayable basis for the stabilization purposes. Benefits of enjoying deposit guarantees are available only to the credit unions fully meeting Association's risk requirements and having obtained status of "Members" of the Association.

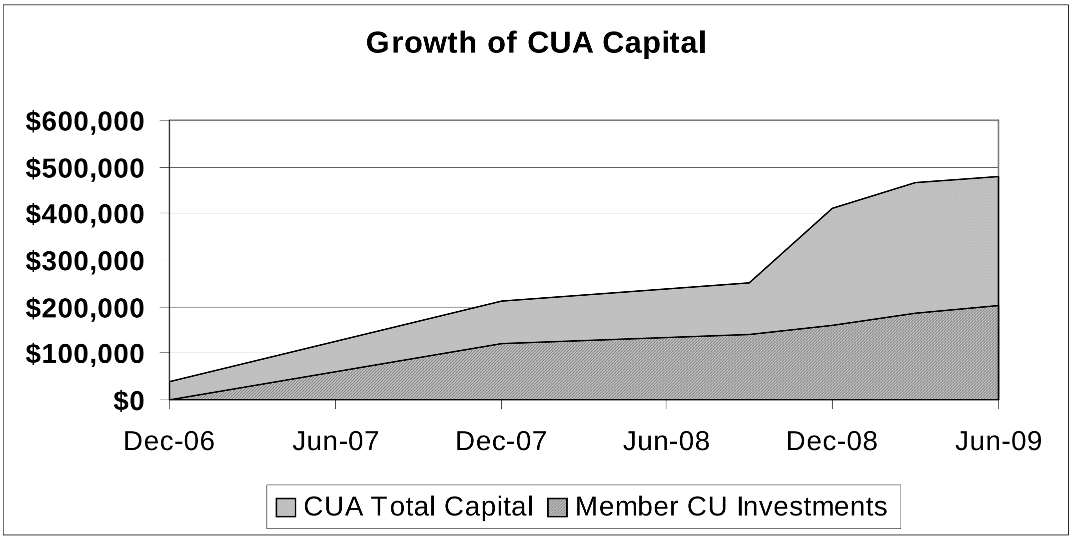
On February 23, 2007 Credit Union Association officially launched the Stabilization Fund and Deposit Guarantee Scheme named "Alyans Garant" and enacted mutual deposit guarantees among seven permanent members. Based on the examination results, 7 credit unions were approved by the Board as Permanent Members and Credit Union Association signed written agreements with all seven in January 2007. As of June 30, 2009 deposit guarantee provided to member credit unions by the CUA remains at the level of Uzbek Soums 1 million (approx. USD 760) per depositor. Member Credit Unions of the CUA receiving deposit guarantee at the end of Quarter 2, 2009 are: CU Lastochka (Navoi), CU Osiyo Trust (Tashkent), CU Ishonch (Jizzakh), CU Nurafshon (Yangikurgan), CU Avitsenna (Bukhara), CU Mador (Kokand), CU Inom (Jizzakh), CU "Faravon" (Termez), CU "Credo" (Bukhara), CU "Tayanch" (Namangan) and CU "Tashabbus" (Fergana). The savings in these 12 guaranteed credit unions compose 21.2% of total savings of all 91 credit unions in the system.

In order to promote safety and soundness within the system and mobilize more member deposits in the credit union system, the project jointly with the Credit Union Association developed and implemented branding strategy with the objective to promote the deposit guarantee facility (within the Stabilization Fund) and its member credit unions, which have been accepted in the system thanks to them meeting and maintaining high operational and financial performance standards. The public awareness campaign was launched twice within the year 2007 in order to achieve the maximum public awareness about the Fund within the limits of approved budget. For this purpose the project hired the agency that will regularly publish PR and informational articles on "Alyans Garant" in the mass-media frequently read by potential members and savers. The following has been achieved:

- New web-site was developed and is being updated on the regular basis (see www.kua.uz).
- Large number of articles about credit union system was published in various newspapers and magazines.
- Within 3 months of 2007 the information on the Stabilization Fund was aired daily on the national radio in Uzbek and Russian languages.

- In order to increase public awareness in the regions the Association jointly with the permanent members and the project prepared information that is published in regional newspapers and aired on regional TV and radio channels.

According to the CUA Board's decision all credit unions participating in this system had to make long-term refundable investments in the Stabilization Fund. The amount of investments for every participating credit union is determined based on number of depositors at the credit union and total balance of deposits. The required investment amount is reviewed every quarter and credit unions have to make additional investments as prescribed by internal regulations of "Alyans Garant" and membership agreements. As of June 30, 2009 total amount of credit union investments in the Fund has exceeded 298 million Soums (approx. 201 thousand US$).
As per for the Cooperation Agreement with USAID the project transferred the grant funds allocated for capitalization of Stabilization Fund. After review of the budget the total amount of funds allocated for this purpose was determined in the amount 227 million Soums (approx. 170 677 US$). The funds were transferred to CUA in October 2008 as the non-interest loan and further donated in July 2009 due to the closure of the project.



Introduction of additional financial services. Beginning from June 2006 CUA is providing short-term funds to credit unions in order to maintain their liquidity position. Maximum term of such product is 6 months. The interest rates on liquidity funds are set by the CUA's Board and are at the level offered by other financial market participants for similar products. The BOD reviews rates every quarter. To access this service credit unions must be permanent members of the Association and meet minimum financial and operational standards set by the Association. In order to increase efficiency and safety of liquidity services the CUA's Board formed Fund's Committee in December 2006. Committee consists of 3 Association's Board Members - representatives from 2 credit unions and WOCCU's Chief of Party (latter Project Director). The administration of the service that was originally executed under the project management and control was completely passed on to the CUA within the third quarter of 2008. WOCCU kept its position in the Fund Committee that makes the final decision on liquidity funds placing and performs the overall control over the Audit Department.
As of June 30, 2009 total cumulative amount of funds placed in participating credit unions reached 3.17 billion Soums (over 2.14 million US$).
As of the end of June 2009 the total amount of income received in 2007-2009 by Credit Union Association from the placement of its funds in CUs for liquidity management purposes by CUs is $121,894 based on the exchange rate as of June 30, 2009.

Development of supportive commercial services. In order to efficiently deliver technical assistance services to both member and non-member (partner) credit unions at the beginning of 2008 the Association founded commercial enterprise “Alyans Garant Servis”, which is a 100%-owned subsidiary, specifically for the purposes to provide consulting and training services to the credit unions. Currently, the Subsidiary has established formal relations (agreements) with 13 partner credit unions that mostly experience the need for operational improvement, the ways of financial monitoring, as well as ability to control the expected growth in assets. All partner credit unions receive off-site consultation, monthly financial performance analysis and recommendations on improvement of their operations. The assistance includes: off-site analysis, distant trainings, provision of necessary legislation and normative documents, development of business plans. All assistance is for fee on full cost-recovery basis.
Total income received by the CUA from the services provided on the paid basis for 2007-2009 years is almost 22 thousand dollars.

Implementation of a new accounting software program in at least 20 credit unions. Software upgrade has been completed in fourteen credit unions – Osiyo Trust (Tashkent), Lastochka (Navoi), Ishonch (Djizak), Asr (Andijan), Avicenna (Bukhara), Sherdor (Samarkand), Mador (Kokand), Nurafshon (Fergana region), Inom (Djizak), Umid (Bukhara), Faravon (Termez), Bukhoro Tadbirkori (Bukhara), Tayanch (Namangan) and Credo (Bukhara). The proper use of the software and correctness of information downloaded is included as the part of the on-site examination procedures and checked on-site whenever CUA Audit Department’s examiners arrive in credit union for examination.
In order to timely upgrade the software in accordance with the needs of credit unions the project cooperates with the developer on on-going basis. The further upgrades the project has been working on include, but are not limited to: assets and liabilities management, consolidation of branch information, and tax calculation modules.

Introduction of agricultural equipment leasing services in the selected credit unions. Project has completed all the necessary preparations for the launch of Agricultural Equipment leasing program. The project and the Association were in the process of signing agreement that would have allowed Association to receive funds and implement the leasing program in the selected credit unions. However, due to the dispute with the former chairwoman, CUA’s Board made a decision to postpone implementation of the proposed agreement until new leadership is elected. Since agricultural equipment leasing component involves significant financial contribution (US$ 500,000 for capitalization of the Association to be used as liquidity source), this component has been put on hold until long-term development plans for the Association can be approved and implemented with a sufficient degree of confidence. Later due to the modification and further assistance and the budget this component has been canceled. All related technical documentation and the research results have been transferred to the CUA for the further implementation in the member credit unions if deemed necessary. The following actions have been completed to develop and implement this component:

- CUA’s Board of Directors approved criteria for credit union participation in piloting of agricultural equipment leasing program. The CUA’s Board selected participating credit unions in February 2007.
- Between March and May 2007 the project has completed marketing research on effective demand and supply of agricultural equipment in the selected regions.
- The project jointly with the Association designed the information materials on agricultural leasing program that were supposed to be distributed to the selected credit unions before rolling out leasing product, including: agricultural equipment catalogue, posters and booklets.
- The project with the assistance of one local and one international consultant has completed the development of a comprehensive leasing manual that includes model internal procedures, model agreements, underwriting procedures and checklists.

- The project jointly with CUA selected leasing officers (experts) within participating credit unions and conducted for them 3-days training on various aspects of leasing operations, including: legal requirements, taxation, accounting, marketing, applications underwriting, etc.
- The CUA's Board jointly with the project determined the interest rates and other terms and conditions on funds to be placed in the participating credit unions for the roll-out of agricultural equipment leasing product.
- The project has developed and CUA Board finalized and approved the participation agreement with credit unions in September 2007.

Phase 4: October 2008- June 2009
Establishment of a Virtual Private Network (VPN) under the auspices of the Credit Union Association providing data exchange services to Uzbek credit unions and introducing new products and services unavailable without efficient and secure data exchange mechanism.
Based on the experience of creating self-sustainable credit union systems in other countries, in order to further strengthen the development process in Uzbekistan, WOCCU proposed to extend the scope of services of Credit Union Association to other non-member credit unions through promoting safety and soundness across the whole system, thus integrating individual credit unions into one network. Integration of all credit unions into one network might be effectively undertaken through establishment of technology based data exchange network based on the reasonable communication infrastructure accessible in remote areas as it was initially presented by WOCCU.

While USAID and WOCCU have agreed on the implementation of a centralized data exchange and data clearing project, some of the major assumptions put as the basis for these objectives were found as unreasonable during the preparation stage. After studying the technical requirements, infrastructure conditions and potential demand for the innovative products the VPN budget assumptions have been changed. During the business planning stage it was identified that the initially proposed technology solution could not be implemented and bids from local/regional providers that came in required additional investment in the start-up. Due to the high price volatility of software products and their maintenance and support the implementation of the project is subject to increased exposure to technology risks.

All results received during the preparation stage have been summarized in the assumptions for the business plan scenario that projects for the VPN operations and financial position for the next 7 years. The business plan scenario, along with all supportive information, was presented to the CUA member credit unions by Oscar Guzman, WOCCU Technical Services Manager, and local project staff in order to make the joint decision on the further strategy and actions. After discussing the results WOCCU jointly with Credit Union Association and associated credit unions have agreed that introduction of such services is premature as it would require much larger investments and longer timeframes than was initially planned as the estimated volume of operations is insufficient to achieve the financial sustainability within next 6 years.

Assessment of Project Performance vs. Quantitative and Qualitative Targets. Up to April 2009 the project was in the preparatory stage for the establishment of the centralized network and data processing center for credit unions, therefore activities to achieve objectives have not been started yet and are scheduled for implementation after launching the VPN. In the beginning of June 2009 the WOCCU Head Office has made a decision to close out the project prematurely.

- ❖ Objective 1a. Ensure that the number of POS devices installed in credit unions and their branches and connected to VPN will be at least 25 by September 30, 2010 (0% completed).
- ❖ Objective 1b. Number of POS devices installed with merchants and connected to VPN will be 15 by September 30, 2010 (0% completed).

- Objective 2a. Number of transactions with merchants processed through VPN will be 40,000 by September 30, 2010 (0% completed).
- Objective 2b. Number of "shared branching" transactions processed through VPN will be 20,000 by September 30, 2010 (0% completed).
- Objective 3. Number of credit information queries processed through VPN will be 5,000 by September 30, 2010 (0% completed).
- Objective 4. Total number of credit unions participating in VPN will reach 20 by September 30, 2010 (0% completed).
- Objective 5. Membership of credit unions participating in VPN will exceed 60,000 by September 30, 2010 (0% completed).
- Objective 6a. Total Savings and shares of credit unions participating in VPN will exceed US$ 55 million by September 30, 2010 (0% completed).
- Objective 6b. Net Loans of credit unions participating in VPN will exceed US$ 63 million by September 30, 2010 (0% completed).
- Objective 6c. Total assets of credit unions participating in VPN should exceed US$ 67 million by September 30, 2010 (0% completed).

- **Establishment of Virtual Private Network (VPN).** In the preparatory stage of the project the following activities have been completed in order to achieve the project qualitative indicators: investigation of the legal, regulatory and taxation regimes for the VPN; marketing research within the credit unions, their members and merchants; tender selection of the major software application; development of the VPN architecture; development of the business plan and financial projections for the VPN; development of the bylaws and operating policies and procedures for the VPN. The business plan scenario along with all supportive information was presented to the CUA member credit unions by Oscar Guzman, WOCCU Technical Services Manager, and local project staff in order to make the joint decision on the further strategy and actions. After discussing the results WOCCU jointly with Credit Union Association and associated credit unions have agreed that introduction of such services is premature as it would require much larger investments and longer timeframes than was initially planned as the estimated volume of operations is insufficient to achieve the financial sustainability within next 6 years.
- **Establishment of credit information exchange component based on the VPN (credit bureau or credit histories exchange mechanism)**. In the reporting quarter the new updated version the draft law "On credit information exchange" finalized by the Cabinet of Ministers was delivered to all responsible agencies including the Credit Union Association. It will be presented to the Parliament for the approval and expected to be enacted in October 2009. The current draft law version requires credit unions to submit information to at least one private credit bureau. Therefore as there is only one credit bureau in Uzbekistan established under the Bankers Association the CUA will start to work with it on inclusion its associated credit unions.
- **Providing CUA's Examination Department with read-only on-line access to credit union accounting systems.** In the last quarter the project has developed the scope of work for the local partner software company to develop special the off-site surveillance module for the CUA's audit department allowing to send on-line queries to the credit unions' accounting system and receive the complete information on all suspicious transactions and trends. It also included the special report on monitoring of the credit unions' liquidity position that will allow the CUA to better monitor the member and partner credit unions' financial position. It is planned that in the third quarter the software developer will complete the upgrade of the CUA Audit Department surveillance system those significantly increasing the effectiveness of risk control.

VI. Conclusions and Recommendations

In general, the goals that have been set up for the project for the past period have been achieved regardless of the internal and external political burdens and problems. However, the implementation of a centralized data exchange and data clearing project was not achieved as some of the major assumptions put as the basis for these objectives were found as unreasonable during the preparation stage.

During the USAID funded Credit Union Development Project a credit union network was created accounting for 91 credit unions. Since the inception of the first credit union, financial cooperatives have proved to be an efficient instrument for mobilizing cash from underneath the mattresses and lending it out in the local communities to primarily fund economic activity of their members. For the last 6.5 years credit unions have been exceeding the targets for savings mobilized and loans issued. That Uzbek credit unions system has been able to double its assets each year, is worth recognizing.

The past few years of project implementation have been marked by the mandate to WOCCU to set up a second tier of the credit union system and create capacity for internal regulation in addition to the monitoring and supervision provided by the Central Bank. At the initiative and support of the project the oldest, largest and best performing credit unions have organized themselves in an association issuing deposit guarantees to each other, providing liquidity management services for the members and performing lobbying services on behalf of the credit union system.

The project has been able to achieve these sets of objectives and established the CUA to meet the highest professional standards expected in the regulatory industry. The Credit Union Association today is a publicly recognized organization as a promoter of credit union services and benefits to membership, defender of credit unions interests and safeguard of financial soundness and stability of credit union system. As a result of the project's support to institutional development the CUA has became financially and operationally self-sustainable and has been able to prove its viability and commitment of its staff and governing bodies to the ideals and principals of democratic governance and safe operations. The CUA is now offering to affiliated member credit unions a range of on-demand services, including deposit insurance fund, liquidity management facility, financial stabilization fund, as well as consultancy on management issues and training sessions. Today the Credit Union Association has 12 credit unions as its members, maintaining high quality financial performance standards and meeting safety and soundness principles.

The Uzbekistan credit union system, while among the youngest in the world, has great potential for the further development.

At the same time the constantly increasing number of the credit unions licensed by the Central Bank not having the professional management and staff and not enforced to follow the true cooperative principles significantly increases the systematic risk. In addition the Central Bank does not have the sufficient capacity to properly supervise and control the credit unions' risks.

All that should force the Credit Union Association to increase its efforts towards: the further improvement of the legislative and normative base based on the cooperative governance and credit unions' philosophy; intensive cooperation with the Central Bank and legislative bodies in order to put the basis for the further consolidation of the credit unions' system and expansion through the development of branch network of the most stable and sound credit unions instead of increasing the number of individual institutions; active promotion of the international operational, financial management and members' interest protection principles within all licensed credit unions; and further development of the supportive services to the credit unions aimed to increase their safety and develop their institutional capacity. It is also important for the CUA to continue active cooperation with the international organizations and donors in order to coordinate all efforts and share with the expertise in the microfinance market development.

The long-term results for the CUA and its associated credit unions should be:

- Increased institutional capacity of the Credit Union Association;
- Increased number of the associated credit unions receiving technical assistance from the Credit Union Association;
- Increased membership number in the CUA member credit unions participating in the deposit guarantee scheme and other financial services;
- Improved capacity of the credit unions and the Credit Unions association to support and fund the development of the networks allowing to integrate into WOCCU's services network;
- Improved legislative and regulative base for the credit unions in Uzbekistan increasing the safety and soundness of the system;
- Securing further possible donor funding to continue technical assistance to the credit union system;

The credit union system in Uzbekistan is experiencing rapid growth, however, it is not homogeneous as it comprises of two competing associations and the larger group of credit unions is not affiliated with any of the Associations. The primary objective of the CUA is performance quality, safety of member savings and financial services to the credit union network. At this time CUA is the only Association concerned about the performance and its further affiliation to WOCCU should allow for faster expansion to non-affiliated credit unions as such partnership adds credibility to CUA's operations and facilitates spread of CUA's and WOCCU's operational standards to the potential members.