Appraisal Environmental and Social Review Summary

Appraisal Stage

(ESRS Appraisal Stage)

Date Prepared/Updated: 03/11/2022 | Report No: ESRSA01981

BASIC INFORMATION

A. Basic Project Data

Country	Region	Project ID	Parent Project ID (if any)
Uzbekistan	EUROPE AND CENTRAL ASIA	P173619	
Project Name	Uzbekistan Financial Sector Reform Project		
Practice Area (Lead)	Financing Instrument	Estimated Appraisal Date	Estimated Board Date
Finance, Competitiveness and Innovation	Investment Project Financing	3/16/2022	5/17/2022
Borrower(s)	Implementing Agency(ies)		
Ministry of Finance	Ministry of Finance		

Proposed Development Objective

The project development objective is to support the authorities in restructuring and/or privatizing state-owned banks, increasing financial resilience to disasters, and expanding finance for exporting MSMEs.

Financing (in USD Million)	Amount
Total Project Cost	15.00

B. Is the project being prepared in a Situation of Urgent Need of Assistance or Capacity Constraints, as per Bank IPF Policy, para. 12?

No

C. Summary Description of Proposed Project [including overview of Country, Sectoral & Institutional Contexts and Relationship to CPF]

The proposed project is consistent with the recently completed Country Partnership Framework for FY 2016-2020 (revised and extended through the 2018 Performance and Learning Review), the Uzbekistan Second Systematic Country Diagnostic—specifically on improving allocation of finance—and is expected to remain closely aligned with the upcoming CPF 2022-2026, specifically its Objective 1.3 on Enhancing the Productive Contribution of Land and Capital to Growth. The project aims to support the authorities of Uzbekistan in restructuring and/or privatizing state-owned banks, increasing financial resilience to disasters, and expanding finance for exporting MSMEs.

The fundamental transformation of SOCB governance, business models and operations and subsequent privatization thereof will help the private sector access better financial services, create a level playing field between state and private banks, reduce distortions created by directed and preferential lending that has benefited the survival of inefficient and non-viable firms. Positive effects will arise from increased bank competition in collecting deposits, granting loans, and overall provision of financial services that are more affordable and suited to the risk profile of the customers. Refocusing the remaining SOCBs toward well-defined economic, social, and political objectives will complement the activity of private banks and foster access to finance. Development and implementation of disaster risk financing strategy will help strengthen financial preparedness to disasters and crises through a better financial planning, protect the economy and state budget, and alleviate disaster impacts on households, especially the most vulnerable.

The proposed project is a five-year Investment Project Financing (IPF) operation. The project will have three technical components and a project management component. Component 1 will focus on modernization, commercialization, and privatization of state-owned banks, Component 2 will aim to support the development of national disaster risk financing (DRF) strategy, its implementation, and capacity building for the IMDA in developing and improving disaster risk insurance and general insurance regulatory and supervisory framework, and Component 3 will focus on improving and enhancing export and trade finance products. Component 4 is a non-technical and covers project management. The proposed budget is US$ 15 million.

Component 1: State-owned banks modernization, commercialization, and privatization (US$ 10.5 million). This Component will support the implementation of the adopted banking sector reform strategy. The ultimate objective is to rationalize state ownership in the banking sector to a point where the number, size, and reach of the SOCBs is commensurate with the state policy objectives. This component will provide: (i) consultancy support and institutional capacity building for MOF to support its ownership function for SOCBs, including transaction-oriented TA on SOCB privatization, (ii) consultancy services to support SOCB restructuring, (iii) investments in SOCB modernization, specifically ICT systems and infrastructure, internal control and risk management systems, digitalization of bank process to reduce operational costs/risks and improve overall operational efficiency, and (iv) assistance to the Banking and Finance Academy for developing and deploying targeted, specialized, and continuous short-term trainings for all levels of banking and financial sector specialists and people interested in financial sector careers, as well as training of trainers program and certification programs.

Component 2: Financial preparedness to disasters and insurance market development (US$ 2.7 million). This component aims to: (i) strengthen financial preparedness of Uzbekistan to disasters; and (ii) improve catastrophe insurance market regulation and supervision. The project will support development of a disaster risk financing (DRF) strategy and action plan. The strategy will determine government priorities and policy actions, relying on analytics and catastrophe modeling prepared by the World Bank. The Strategy's implementation will include design and operationalization of a financial risk management instruments to mobilize private sector co-financing and build on the capacities of Uzbekistan's insurance market to share risks between the public and private sectors. In particular, this component will finance: (i) a feasibility study for a DRF instrument as envisaged in the DRF strategy implementation plan; (ii) the technical design of structuring the instrument, its standard operating procedures, and other operational documents; (iv) implementation of the reserve fund's or centralized insurance pool's funding structure, governance, staffing, audit and reporting; (v) implementation of a risk financing plan that is reviewed and updated annually, potentially leveraging on (re)insurance sector. Relatedly, IMDA has recognized the need for building its capacity to strengthen the regulation and supervision for insurance and its credibility as an independent regulator. This component will also support the strengthening of the IMDA capacity to regulate and supervise the insurance sector in line with IAIS core principles, including on catastrophe risk insurance.

Component 3: Export and trade financing instruments (US$ 1.0 million). This component will provide technical and institutional building support to the EPA in improving and enhancing its export and trade finance products. In particular, the project will finance: (i) consultancy services to conduct a comprehensive review and assessment of the ESuF's operations and efficiency of its instruments, with the possibility to broaden them; (ii) capacity building of the staff of EPA and ESuF on export finance instruments, including through fact-finding and study visits to solid foreign partners for on-site learning and knowledge exchange.

Component 4: Supporting Project Management (US$ 0.8 million). This component will support Project implementation, including the Project's monitoring and evaluation, application of environmental and social standards, Project related audits, training and financing of incremental operating costs. The project implementation unit (PIU) at the MoF will manage the provision of financial resources, perform fiduciary functions, ensure compliance with environmental and social safeguards, and monitor and evaluate the project implementation.

D. Environmental and Social Overview

D.1. Detailed project location(s) and salient physical characteristics relevant to the E&S assessment [geographic, environmental, social]

Uzbekistan is a lower-middle income country that is rich in natural resources and landlocked, bordering with all other Central Asia countries and Afghanistan. Its geographical area is 458,000 sq km and is the most densely populated country in Central Asia with a population of about 34.5 million. Uzbekistan is prone to many natural disasters and climate change is already a clear and imminent threat. The estimated annual economic losses from natural disasters are around 0.2 percent of GDP–the highest in Central Asia. Around 15 percent of the country confronts a very high seismic risk, concentrated in the Tashkent and Bukhara regions, home to more than half the country's population and 65 percent of GDP. While major earthquakes are infrequent, smaller disasters including climate-induced events, happen every year, as Uzbekistan also faces floods, droughts, landslides, and mudflows. With climate change, the frequency and severity of climate-related disasters is likely to increase.

Uzbekistan is transforming the foundations of its economy and social contract through three major shifts: from central planning to a market economy; from state to private ownership; and from isolation to economic integration. Government of Uzbekistan (GoU) has adopted a five-year Development Strategy (2017-2021) emphasizing five governance related principles for accelerating sustainable development: i) improving state and public administration, ii) further strengthening the role of the Oliy Majlis (parliament), iii) economic development and liberalization, iv) development of the social sphere, and v) ensuring security, inter-ethnic harmony and religious tolerance via the implementation of a balanced, mutually beneficial, constructive foreign policy. While several areas have made progress, further reforms are needed particularly in the financial sector which is bank-dominated, primarily state-owned, and highly concentrated. Twelve state-owned commercial banks (SOCBs) -out of 33 commercial banks- hold around 81 percent of total sector assets and 86 percent of total credit. The government is the sole or vast majority (over 90 percent) shareholder of these SOCBs.

Until recently, the SOCBs had been lending primarily to priority sectors and SOEs at a below-market rate, lacking strong governance, risk management and oversites. SOCBs have consistently underperformed private banks and generated high contingent fiscal liabilities. Meanwhile, micro-, small, medium enterprises' (MSMEs') access to finance remains low in Uzbekistan compared with peer countries, which prevent boosting dynamics in the economy, innovation and job creation. Restructuring SOCBs and changing their business models is critical for the financial sector in Uzbekistan, and developing alternative financing for MSME is much needed.

In addition, the capacity of the government and people to cope with the cost of disasters is limited. The government has limited pre-arranged financing to cover the cost occurring after disasters. Households have limited access to risk financing, thus mostly relying on government assistance after disasters. Disaster insurance penetration is low – less than 10 percent of residential dwellings. The insurance market also faces a range of interconnected acute issues such as ineffective risk management and transfer, the absence of sound consumer protection, limited product mix, partially due to outdated regulatory and supervisory framework.

In 2020, a comprehensive Banking Sector Reform strategy set the reform agenda for the next five years and included the strategic mapping of SOCBs. The strategy includes actions to advance SOCBs' privatization and restructuring, micro and macroprudential oversight, and the development of a non-bank financial providers ecosystem. The ownership function and oversight over SOCB restructuring and privatization was centralized in the MoF, based on the strategy. A dedicated Banking Reform Department was established in May 2019, reporting directly to the First Deputy Minister of Finance. The Department has been actively engaging with SOCBs on the development and implementation of transformation plans. However, the transformation processes in SOCBs have been largely inconsistent, urging the MOF to provide structured high-level guidance for the processes. Also, the transformation progress has been uneven across SOCBs. The project aims to tackle these issues while supporting the implementation of the recently adopted banking sector reform strategy. The proposed project is expected to be implemented at the national level with the Ministry of Finance, SOCBs, and other relevant/ministries/institution through several technical assistances and modernizing ICT/digital infrastructure. Specific locations of physical interventions are expected to be mostly within the footprint of the existing facilities.

D. 2. Borrower's Institutional Capacity

The Ministry of Finance (MOF) of the Republic of Uzbekistan will be the overall implementing agency. MOF is well versed with the World Bank as it is currently managing two World Bank financed projects – Covid 19 (P173827) and Institutional Capacity Building (IBL) (P168180). While, the project's overall implementation responsibility will rest with the Ministry of Finance (MOF), they will draw upon the expertise of other agencies as required. Components 1, 2 and 4 are expected to be technically led by the Ministry of Finance. Component 3 will be technically led by the Ministry of Investments and Foreign Trade (MIFT).

The PIU has been established within the MOF under the IBL project. The same PIU will also support the implementation of this project. As the Covid 19 is premised on the Bank's new ESF, The PIU is aware of the environmental and social requirements.

The PIU will be responsible for all project activities, preparing the annual work plan and annual report, ensuring timely submission of required reports, organizing project audits, and preparing supervision missions. Under each subcomponent, different beneficiary agencies will be involved as follows: Component 1) MOF, Banking and Finance Academy, SAMA, CBU, Component2) MOF, IMDA and Component 3) MIFT, EPA and ESuF. The PIU under MOF will ensure oversight of the environmental and social aspects of the project activities in these beneficiary agencies as needed.

II. SUMMARY OF ENVIRONMENTAL AND SOCIAL (ES) RISKS AND IMPACTS

A. Environmental and Social Risk Classification (ESRC) Moderate

Environmental Risk Rating Moderate

The proposed Project's Environmental Risk Rating is moderate. The proposed project activities are not expected to have any large, significant or irreversible environmental impacts, as it will mostly finance consulting and advisory services such as capacity building, and training to enhance the authorities' capacity in the financial sector. These consulting and advisory services also support the development and implementation of the national disaster risk financing strategy and relevant capacity support. Thus, the project is expected to have positive impacts by enabling the financial sector to better manage and respond to climate and natural disaster risks. The proposed activities include financing investment in modernizing the core infrastructure of the State-owned-banks to support the commercialization of SOCBs, in particular ICT systems and infrastructure (sub-component 1.3). As a part of SOCB modernization, participating SOCB's Environmental Social Management System (ESMS) will be enhanced to strengthen the SOCB's capacity of environmental and social risk management in their operations. Overall, no major construction works or physical works impacting the environment are expected. The detailed scope of modernizing ICT infrastructures may vary depending on the SOCBs but is mostly upgrading IT equipment and relevant software installation related to the banking systems, as to be requested by the MOF. This might create issues such as small rehabilitation and disposal/recycling of electronic waste when equipment is replaced. These issues could be easily mitigated through an Electronic Waste Management Plan (E-WMP) and an Environmental and Social Management Framework (ESMF) checklist. The scope of upgrading necessary ICT infrastructure should be further defined as the project proceeds and the client will prepare E-WMP and ESMF checklist and review with the Bank prior to appraisal.

Social Risk Rating Moderate

The Social Risk is moderate. The proposed project is expected to result in significant positive impacts as it would lead to : (i) enhanced corporate governance and risk management of banks; (ii) transformation of SOCB business models and operations from the previous "state-agent" role to a new competitive banking role; and (iii) refocusing the SOCBs towards well-defined market "gap-filling" and ensuring financial inclusion and access so as to better serve the needs of the hitherto deprived segments such as low-income household, rural populations, micro and small firms. under compoent 2These measures thereby would improve access to finance and financial inclusion under component 3 of the project. The interventions are exclusively 'software' oriented encompassing policy changes, capacity building and capacity support including digitalization. No new civil / construction works are envisaged. Given this, two issues assume significance—one, the pace of reforms and outreach. The former would depend upon the overall country's political economy and governance as well as the institutional capacity. The latter falls under the purview of the 'project' and planned efforts are essential to ensure that it reaches out and engages systematically with the stakeholders, both at the project and national level. This will not only help in keeping the country informed but also avoid any misunderstandings and mis-information campaigns. The outreach related risk is expected to be low to moderate as the project will support the implementation of the Banking Sector Reform Strategy 2020-25, prepared by the WB and approved by GOU in May 2020. Already the adoption of the strategy was followed by massive communication campaign with TV interviews and briefings as well as articles on web. These initiatives will be expanded and taken forward through the project Stakeholder Engagement Plan (SEP).

B. Environment and Social Standards (ESSs) that Apply to the Activities Being Considered

B.1. General Assessment

ESS1 Assessment and Management of Environmental and Social Risks and Impacts

Overview of the relevance of the Standard for the Project:

The project will have mostly positive benefits as the interventions aim at enhancing the financial sector and support the government's adopted banking sector reform strategy for 2020-2025. The project finances mostly consulting and advisory services to support capacity building, training, and feasibility assessment types of activities. The project does not support any civil works and environmental risks are confined to small rehabilitation issues for the installation of new equipment, and disposal/recycling of electronic waste when equipment is replaced in upgrading ICT infrastructure of the bank systems. These could be easily mitigatable with an Electronic Waste Management Plan and an ESMF checklist, respectively. On the social front, reaching out to the stakeholders surface as an issue which will be addressed through a detail Stakeholder Engagement Plan SEP.

The risks are covered by ESS 1, ESS 2, ESS 3, ESS 4, and ESS 10. The task team recognizes the reform agenda as an opportunity to ingrain the environmental and social agenda into the functioning of the financial institutions. Towards this, it is apt that financial institutions develop risk management systems similar to ESMS - which comprises policies, systems, procedures and resources to manage E&S risk in lending operations—as outlined in ESS 9. As the project does not have any lending operations, efforts will be made for a generic strategy as well as a guidance note outlining the requirements of E&S management systems to be adopted by financial institutions in lending operations. This apart, it will be ensured that all large scale consultancies supporting re-structuring and/ or privatization shall take due note ot E&S requirements. Further, SOCB senior management shall be imparted on executive training on bank risk management including E&S risk management. As a part of the overall and continuous capacity building of the sector, assistance will be provided to the Banking and Finance Academy in introducing specialized and continuous educational programs, trainings, and workshops in cooperation with leading international banks, consultants, and educational institutions.

ESS10 Stakeholder Engagement and Information Disclosure

The project recognizes the need for an effective and inclusive engagement with all of the relevant stakeholders and the population at large. Key stakeholders will include the financial institutions and their prospective customers such as individuals, MSMEs, private entrepreneurs, exporters and other industries, Meaningful consultations and disclosure of appropriate and timely information assume huge significance not only in reaching out to project-affected people and other stakeholders, but also avoids any misunderstandings and misinformation campaigns. In this backdrop, the project will prepare a detailed SEP which serves the following purposes: (i) stakeholder identification and analysis; (ii) planning engagement modalities, namely effective communication tools for consultations and disclosure; and (iii) enabling platforms for influencing decisions; (iv) defining roles and responsibilities of different actors in implementing the Plan; and (iv) a grievance mechanism (GM) for project activities, as well as outlining the broader communications the project will support as part of project design.
The GM will accept, review, and seek to resolve any project related concerns or feedback, and be easily accessible to all the stakeholders. The GM will also have a special window to address SEA/SH complaints such as to ensure privacy and dignity of the affected persons. The GM will also include a dedicated platform for registering and processing labor related complaints.

B.2. Specific Risks and Impacts

A brief description of the potential environmental and social risks and impacts relevant to the Project.

ESS2 Labor and Working Conditions

The project will have the following categories of the workers: direct and contract. The project will include; adequate occupational health and safety measures (including emergency preparedness and response measures); grievance arrangements for project workers; measure to incorporate labor requirements into the ESHS specifications. These and other measures related to working conditions, equality of opportunity and workers' associations will be documented in labor management procedures (LMP). The direct workers will be essentially technical consultants deployed at PIU who will be governed by an explicit mutually agreed contract, reviewed and cleared by the World Bank. Contract workers will be those employed by the contractors supplying equipment's and/ or other machineries. These apart, there will be a host of government civil servants who will be governed by their contracts and service codes.
No significant civil works or construction are envisaged as the project will mostly finance technical assistance types of work and the installation of and upgrading IT equipment and systems and works necessary for that installation. Any labor for minor equipment installation and related minor rehabilitation will be included in the installation contracts or as direct work hired by the project for that purpose. Given the COVID situation, a checklist and guidance note will be prepared (as a part of the LMP) for governing the conduct of all workers to ensure health and safety. These instruments include: EHS checklists, codes of conduct that include measures to prevent Sexual Exploitation and Abuse/Sexual Harassment (SEA/SH); safety training etc. All workers will have access to the project specific GM with a dedicated window for workers complaints.

ESS3 Resource Efficiency and Pollution Prevention and Management

Relevant aspects of ESS3 shall be consider as needed. Upgrading the ICT infrastructure could potentially involve replacing and disposing old electronic equipment, which might also include hazardous substance. The Electronic Waste Management Plan and ESMF checklist is being prepared to mitigate these issues.

ESS4 Community Health and Safety

The improper disposal of electronic waste could pose health and safety risks to communities. Thus, the client will prepare an Electronic Waste Management Plan prior to the project appraisal.

ESS5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

Project is not financing any construction activities and the project activities are confined to the existing footprint of facilities.   Hence, no lands need to be acquired.

ESS6 Biodiversity Conservation and Sustainable Management of Living Natural Resources

All works are expected to be conducted within the existing footprint of facilities. Therefore, ESS 6 is not relevant to the proposed project interventions.

ESS7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities

There are no indigenous people in Uzbekistan.

ESS8 Cultural Heritage

All works are expected to be conducted within the existing footprint of facilities. Therefore, ESS 8 is not relevant to the proposed project interventions.

ESS9 Financial Intermediaries

Project does not plan interventions through financial intermediaries. As part of the modernization and risk management upgrades and development of internal control and risk management systems under component 1.3, the SOCBs will need to ensure that the consulting activities involve the development of E&S risk management systems (ESMS) similar to one ingrained in ESS 9.

C. Legal Operational Policies that Apply

OP 7.50 Projects on International Waterways	No
OP 7.60 Projects in Disputed Areas	No

B.3. Reliance on Borrower's policy, legal and institutional framework, relevant to the Project risks and impacts

Is this project being prepared for use of Borrower Framework?	No

Areas where "Use of Borrower Framework" is being considered:

The Borrower's framework will not be used for this project.

IV. CONTACT POINTS

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Borrower/Client/Recipient

Borrower: Ministry of Finance

Implementing Agency(ies)

Implementing Agency: Ministry of Finance

V. FOR MORE INFORMATION CONTACT

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VI. APPROVAL

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