



RESTRUCTURING PAPER
ON A
PROPOSED PROJECT RESTRUCTURING
OF
KG FINANCIAL SECTOR DEVELOPMENT PROJECT
APPROVED ON MARCH 8, 2012
TO
THE KYRGYZ REPUBLIC

FINANCE, COMPETITIVENESS AND INNOVATION

EUROPE AND CENTRAL ASIA

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ABBREVIATIONS AND ACRONYMS

BETF	Bank-Executed Trust Fund
CCRO	Central Collateral Registration Office
DPA	Deposit Protection Agency
FSDP	Financial Sector Development Project
GOKR	Government of the Kyrgyz Republic
IDA	International Development Association
IPF	Investment Project Financing
KPO	Kyrgyz Post Office
MFO	Micro Finance Organizations
MS	Moderate Satisfactory
MU	Moderate Unsatisfactory
NBKR	National Bank of the Kyrgyz Republic
PDO	Project Development Objective
PCU	Project Coordination Unit
SDR	Special Drawing Right
SECO	Swiss State Secretariat for Economic Affairs
TA	Technical Assistance
TF	Trust Fund



BASIC DATA

Product Information

Project ID P125689	Financing Instrument Investment Project Financing
Original EA Category Not Required (C)	Current EA Category Not Required (C)
Approval Date 08-Mar-2012	Current Closing Date 30-Jun-2020

Organizations

Borrower Ministry of Finance	Responsible Agency Kyrgyz Post Office, National Bank of the Kyrgyz Republic, Ministry of Justice
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Project Development Objective (PDO)

Original PDO

Project Development Objectives are to: (i) enhance financial sector stability, and (ii) increase access to financial services.

Summary Status of Financing

Ln/Cr/Tf	Approval	Signing	Effectiveness	Closing	Net Commitment	Disbursed	Undisbursed
IDA-50670	08-Mar-2012	11-Jul-2013	25-Dec-2013	30-Jun-2020	4.03	2.20	1.39
IDA-H7600	08-Mar-2012	11-Jul-2013	25-Dec-2013	30-Jun-2020	4.92	4.02	.60

Policy Waiver(s)

Does this restructuring trigger the need for any policy waiver(s)?

No



I. PROJECT STATUS AND RATIONALE FOR RESTRUCTURING

A. Project Background:

The Kyrgyz Republic Financial Sector Development Project (FSD project), approved on March 8, 2012 and effective on December 25, 2013, comprises US\$8.85 million IDA allocation (US\$ 3.93 million credit; US\$ 4.92 million grant). The Project Development Objective (PDO) is to 1) enhance financial sector stability; and 2) increase access to financial services. The FSD project consists of four components:

- Component 1: Strengthening the institutional capacity of the National Bank of the Kyrgyz Republic (NBKR), implemented by NBKR - SDR 230,000 (US\$ 320,000)
- Component 2: Enhancing financial services via Kyrgyz Post Office (KPO) network, implemented by KPO - SDR 4.4 million (US\$ 5.9 million)
- Component 3: Modernizing the secured transactions and debt resolution regime, implemented by the Central Collateral Registration Office, CCRO - SDR 750,000 (US\$ 1.0 million)
- Component 4: Project coordination and monitoring – SDR 520,000 (US\$ 889,000)

The Swiss State Secretariat for Economic Affairs (SECO) BETF (US\$5.4 million) complements the interventions of the IDA financed FSD project. The SECO BETF project development objective is to enhance financial sector stability by strengthening the regulatory and supervisory framework (both prudential and market conduct) of financial institutions (e.g. banks, credit unions, and micro finance organizations), including the capacity of NBKR as a financial sector regulator; and the capacity of the Deposit Protection Agency (DPA) as a financial safety net participant. The BETF have been implemented in two phases. The first phase started on August 14, 2013 and closed on December 31, 2017; the total amount of the first phase was US\$3 million out of which US\$2.2 million was disbursed. The second phase started on January 1, 2018 and closes on December 31, 2021; the total amount of the second phase is US\$3.2 million.

The FSDP had been restructured three times. The Project underwent a first (level-1) restructuring approved on May 8, 2013, to drop a component on Aiyl Bank deposit mobilization and privatization and partially cancel the respective IDA credit and grant allocations. The restructuring was conducted in response to parliamentarians' concerns related to the concept of Aiyl Bank's privatization as stipulated in the said component. The same restructuring also extended the Project closing date by one year from June 30, 2017 to June 30, 2018, and adjusted the results framework accordingly. The second (level-2) restructuring was approved on June 29, 2018 and consisted of a 2-year extension of the project, giving KPO more time to implement the IT-system that is essential for the distribution of basic financial services in the rural area. The third (level- 2) restructuring was approved on February 18, 2019 and consisted of the minor reallocation of funds between the components.

B. Project Status

The Project has been in actual problem status since February 2020, both Progress achieving Project Development Objective and Implementation Progress have been rated Moderately Unsatisfactory (MU).

- Progress achieving Project Development Objective (PDO) was downgraded to MU, because 1) it is likely that the PDO 1, enhance financial stability, will only be achieved partly. This is evidenced by the PDO indicator,



strengthening the legal, regulatory and supervisory framework. Although the NBKR implemented a new Banking Law, revised several bank regulations, and strengthened its supervisory approach (in close cooperation with the IMF and supported by the Bank Executed Trust Fund financed by SECO that is linked to this operation), there is a need for critical amendments of the Banking Law and other legislations in the area contingency planning and crisis preparedness; and 2) it has become clear that PDO 2, increase access to financial services, is also likely to be achieved partly before the closing of the project on June 30, 2020. This is evidenced by the PDO indicator, number of financial transactions going through the KPO, that stands at 7.7 million by the December 31, 2019 and is very likely not reach the target of 17 million by June 30, 2020.

- The Implementation Progress was downgraded to MU, because there is a risk that the KPO will not fully finish the implementation of its activities before the closing of the project on June 30, 2020 (e.g. establish strategic partnerships with banks to become a bank agent, fully implement the IT infrastructure, and centralize the financial management system).

Status by components:

Component 1 - NBKR is in the process of executing the procurement plan (US\$ 218,614 [69%] out of US\$ 317,781 is to be disbursed, and not yet committed). The activities under this component (building institutional capacity through the training programs) were expected to be completed before the closing of the project on June 30, 2020 before the COVID-19 pandemic.

Component 2 - KPO is implementing the IT system to connect the post offices with financial institutions, centralizing and digitalizing financial management, and arranging training for KPO Staff (US\$ 2.3 million is to be disbursed of which US\$ 1.7 million is already committed, and US\$ 578,710 [10%] out of US\$ 5.9 million is yet to be committed). The COVID-19 pandemic came at a crucial moment for the project implementation.

- KPO completed the test phase on May 31, 2019 and completed the implementation of the IT system in 230 post offices (which is 64% of the target of 360 post offices). The implementation of the IT-system in the remaining 130 post offices were expected to be completed before the closing of the project on June 30, 2020, including the installation of the POS Payment devices for card payments under the bank agency agreements.
- The transition from a decentral and paper based to a central and electronic based financial administration is progressing. The Financial Management Application supporting the centralization and digitalization were expected to be completed before the closing of the project on June 30, 2020.
- The audit of the financial statements of 2016 and 2017 has been finalized on May 24, 2019 and published on the website of the KPO on June 18, 2019. The financial audit of 2018 was finalized by the external auditor and shared on January 23, 2020. Preparations for the audit of the financial statements of 2019 have been delayed because of the COVID-19 pandemic.
- The staff capacity in the regional and rural post offices is developing as a result of the roll out of training programs which will continue in the coming months. Currently 476 employees (which is 40% of the target of 1200) have been trained. The training of the remaining 724 employees were expected to be completed before the closing of the project on June 30, 2020.



- There remains a pressing need for KPO to become a bank agent by establishing strategic partnerships with banks. KPO recently hired a consultant to establish a bank agency agreement. Implementation of the bank agency agreement were expected to be completed before the closing of the project on June 30, 2020.
- It has become clear that the PDO indicated by the increase of financial transactions will not be achieved by June 30, 2020. KPO's potential is evident and it is possible to reach the PDO after full implementation of the project (the implementation of the IT system, centralization and digitalization of financial administration, and improved staff capacity) as enablers to work on partnerships with the banks to fill in the gaps in the financial infrastructure.

Component 3 - The Ministry of Justice (MOJ) is in the process of executing the procurement plan that will support the second phase of the reform (US\$ 199,162 is yet to be disbursed of which US\$ 72,145 is committed, and US\$ 127,017 [12%] out of US\$ 1 million is yet to be committed).

- The first legal and regulatory amendments have been enacted (e.g. making it possible for on-line registration of movable collateral). Before the COVID-19 pandemic it was expected that the target of the PDO indicator, number of annual registrations of movable collateral in the collateral registry, would be achieved before the closing of the project on June 30, 2020.

The Government of the Kyrgyz Republic (GOKR) has requested on April 23, 2020 an extension of the project closing date, to be able to complete the project activities. An extension of 12 month would bring the cumulated project implementation period to 7.5 years.

C. Status Procurement and Financial Management

Both the Procurement progress and the Financial Management are satisfactory. There are no outstanding audits.

D. Rationale for restructuring

The restructuring is primarily the result of the COVID-19 pandemic related lockdown by the Government of the Kyrgyz Republic on March 23, 2020. This came at a crucial moment of the project implementation and is delaying the implementation of the project. Currently, the essential procurement is completed and the activities are in the implementation phase. Establishment of the KPO as a bank agent would strongly contribute to the economic recovery of the regions after the COVID-19. The term of the extension of 12 months is warranted because it is expected that due to the slowdown of the economy it would take longer time to resume and complete the work after the sudden disruption, and it is not clear when normal business would resume. It is important to mention that there also have been other unexpected delays in the implementation of the project before the COVID-19 pandemic (e.g. signing of the contract between KPO and the supplier of the IT infrastructure was 4 months delayed because of the fear of corruption; the former Director General of KPO had the unrealistic ambition to become a bank instead of a bank agent, and the sudden resignation of the former Director General in January 2020 created a nearly two months vacuum in KPO's decision making process).

It is expected that the restructuring, including an extension of 12 months, and the revision of the results framework, will make it possible to achieve the PDO.

II. DESCRIPTION OF PROPOSED CHANGES

The following changes are proposed:



A. Change in Results Framework:

Component 2 - The target of the project development indicator changed from 17 million to 11 million. The target of 17 million appeared not realistic. The volume of transactions went down from 10 million (baseline in 2013) to 8.6 million (December 31, 2019), because of the increased competition by banks and payments service providers, growing access infrastructure via ATMs and POS terminals, the decline in cash delivery of pensions especially in urban areas, in combination with delays in implementation of access infrastructure by KPO. The intermediate indicator ‘implementation of a bank agency agreement in 3 post offices’ was added to explicitly measure the implementation of the bank agency model. Also added was the intermediate indicator ‘number of ICT-equipped Post Offices that is connected to (bank) card payment terminal’ to make sure that the clients at post offices should be able to pay different financial services with a (bank) payment card.

Component 3 – Intermediate indicator ‘Increase in lending based on new registration of security interests in the registry, using moveable assets as collateral’ has been removed because it appeared that this data is not available.

B. Change in loan closing date:

It is proposed to extend the loan closing date for all components by 12 months from June 30, 2020 to June 30, 2021. The extension will allow the project activities to be fully completed. The 12 months are needed because it is expected that due to the slowdown of the economy it would take longer time to resume and complete the work after the sudden disruption of COVID-19.

C. Change in Disbursement estimates:

The disbursement of fiscal year 2020 and 2021 (after restructuring) is estimated as following:

year	FY2013*	FY2014*	FY2015*	FY2016*	FY2017*	FY2018*	FY2019*	FY2020	FY2021	Total
disbursement	0	US\$450K	US\$298K	US\$468K	US\$943K	US\$669K	US\$1,1M	US\$1,8M	US\$2.6M	US\$8.85M

*actual disbursement

The estimated disbursement is primarily based on the payment schedule of the procured IT system (hardware and software) and an even intensity of capacity building during the extension.

D. Change in overall Risk Rating

The overall risk rating is changed from High to Moderate because of the upgrade of the Political and Governance from Substantial to Moderate, the upgrade of the Technical Design of the Project from High to Moderate, the upgrade of the Institutional Capacity of Implementation from High to Moderate, and the Stakeholders from High to Moderate. The upgrade of Political and Governance is warranted by the appointment of a new Director General with a strong mandate from the Kyrgyz Government. The upgrade of the Technical Design is warranted because the Project reached the actual implementation phase (overcoming the complex technical design). The upgrade of the Institutional Capacity of Implementation is warranted because of the involvement of national and international consultants supporting the Implementing Agencies. The upgrade of Stakeholders is warranted because the Project is being implemented and is making progress (overcoming potential pushback from stakeholders).

E. Change in Implementation Schedule:

The implementation schedule will be extended by 12 months.



III. SUMMARY OF CHANGES

	Changed	Not Changed
Results Framework	✓	
Loan Closing Date(s)	✓	
Disbursement Estimates	✓	
Overall Risk Rating	✓	
Implementation Schedule	✓	
Implementing Agency		✓
DDO Status		✓
Project's Development Objectives		✓
PBCs		✓
Components and Cost		✓
Cancellations Proposed		✓
Reallocation between Disbursement Categories		✓
Disbursements Arrangements		✓
Safeguard Policies Triggered		✓
EA category		✓
Legal Covenants		✓
Institutional Arrangements		✓
Financial Management		✓
Procurement		✓
Other Change(s)		✓
Economic and Financial Analysis		✓
Technical Analysis		✓
Social Analysis		✓
Environmental Analysis		✓

IV. DETAILED CHANGE(S)



LOAN CLOSING DATE(S)

Ln/Cr/Tf	Status	Original Closing	Revised Closing(s)	Proposed Closing	Proposed Deadline for Withdrawal Applications
IDA-50670	Closed	30-Jun-2017	30-Jun-2018, 30-Jun-2020	30-Jun-2021	30-Oct-2021
IDA-H7600	Closed	30-Jun-2017	30-Jun-2018, 30-Jun-2020	30-Jun-2021	30-Oct-2021

DISBURSEMENT ESTIMATES

Change in Disbursement Estimates
Yes

Year	Current	Proposed
2012	0.00	0.00
2013	0.00	0.00
2014	450,000.00	450,000.00
2015	300,000.00	298,000.00
2016	467,000.00	468,000.00
2017	875,000.00	943,000.00
2018	1,425,000.00	669,000.00
2019	3,000,000.00	1,100,000.00
2020	1,883,000.00	1,800,000.00

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating at Approval	Current Rating
Political and Governance		● Moderate
Macroeconomic		● Moderate
Sector Strategies and Policies		● Moderate
Technical Design of Project or Program		● Moderate
Institutional Capacity for Implementation and Sustainability		● Substantial
Fiduciary		● Moderate



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Environment and Social	● Low
Stakeholders	● Substantial
Other	
Overall	● Moderate



Results framework

COUNTRY: Kyrgyz Republic

KG Financial Sector Development Project

Project Development Objectives(s)

Project Development Objectives are to: (i) enhance financial sector stability, and (ii) increase access to financial services.

Project Development Objective Indicators by Objectives/ Outcomes

Indicator Name	PBC	Baseline	End Target
Strengthening legal, regulatory and supervisory framework for banks, MFOs and credit unions.			
Number of changes to the legal, regulatory and supervisory framework are implemented (Number)		0.00	2.00
Enhancing financial services via KPO network			
Number of financial services transactions going through KPO (Number)		10,000,000.00	11,000,000.00
Action: This indicator has been Revised			
Modernizing secured transactions and debt resolution regime			
Number of new annual registrations in the secured transactions registry, using moveable assets as collateral (alone or in combination with immoveable collateral) (Number)		1,354.00	2,500.00



Intermediate Results Indicators by Components

Indicator Name	PBC	Baseline	Intermediate Targets									End Target
			1	2	3	4	5	6	7	8	9	
Strengthening Institutional Capacity of the NBKR												
Improved staff capacity, measured in terms of number of years of staff experience in supervision departments (Number)		2.00	2.50	3.00	3.50	4.00		4.00	3.50	3.00	2.50	4.50
Supervisory staff conducted spacialist training (Number)		0.00										25.00
Enhancing financial services via KPOs network												
Number of ICT-equipped Post Offices (with installed, operational front office cash terminals) connected to the central hub (Number)		0.00	0.00	50.00	150.00	250.00						360.00
Revenues from non-government financial services transactions (payment,		15.00	15.00	16.00	17.00	18.00		33.00	26.00	20.00	15.00	20.00



Indicator Name	PBC	Baseline	Intermediate Targets									End Target
			1	2	3	4	5	6	7	8	9	
remittances, bank) as a share of total KPO revenues from financial services (including also pension pay out and social allowances (Percentage)												
Improved quality, reliability and cost-efficiency of small value payments operations, measured in terms of same day Straight Through Processing as a share of total transactions to&from bank accounts (Text)		0%	0%	>5%	>10%	>20%		>40%	>25%	>10%	0%	>30%
Enhanced transparent financial performance (Text)	No	No		Audit of 2012 IFRS accounts of published and management letter issued	Audit of IFRS/ Accounts of SE or Opening Balances sheet JSC	Annual audited statements		Annual audited statements	Audit of IFRS/ Accounts of SE or Opening Balances sheet JSC	Audit of 2012 IFRS accounts of published and management letter issued	No	Annual audited statements 2016, 2017, and 2018.
Introduction of performance measurement, in terms of accounting		0.00	0.00	0.00	Monthly financial reports	Monthly financial reports		Monthly financial reports	Monthly financial reports	0.00	0.00	Monthly financial reports



Indicator Name	PBC	Baseline	Intermediate Targets									End Target
			1	2	3	4	5	6	7	8	9	
Action: This indicator is New	Rationale: <i>In order to offer financial services in the rural area, the KPO needs to implement the bank agency agreement in several post offices.</i>											
Number of ICT-equipped Post Offices that is connected to (bank) card payment terminal (Number)		0.00										360.00
Action: This indicator is New	Rationale: <i>The clients at post offices should be able to pay different financial services with a (bank) payment card.</i>											
Modernizing the secured transactions and debt resolution regime												
Amended legal framework for moveable collateral and debt resolution regimes (Number)		0.00										2.00
Issued regulations for the well-functioning of the collateral registry (Number)		0.00										4.00
Online system for registering collateral is operational and connected to other assets registrations		No online system	No	No	Yes	Yes		Yes	Yes	No	No	On-line registration system is operational and at least



Indicator Name	PBC	Baseline	Intermediate Targets									End Target
			1	2	3	4	5	6	7	8	9	
(for example (registration of vehicle registration) (Text)												connected to another asset registration system (for example system of vehicle registration)
Number of dissemination and capacity-building and training events held (Number)		0.00	0.00	1.00	3.00	5.00		5.00	3.00	1.00	0.00	6.00
Increase in lending based on new registration of security interests in the registry, using moveable assets as collateral (Text)		To be determined before the end of 2018.										To be determined by September 30, 2019
Action: This indicator has been Marked for Deletion												
Increase in the debt recovery rate for creditors (Text)		zero	No increase	No increase	No increase	No increase		No increase	No increase	No increase	No increase	30 cents on the dollar of 4% of insolvent companies



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