

# **Working Paper: Financial Inclusion and Rural Finance Sector Assessment and Recommendations for the Carbon Sequestration through Climate Investment in Forests and Rangelands (CS-FOR)**

## **Subcomponent 3.2: Climate-sensitive Value Chains Financing**

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## Currency units

As of March 31, 2018

Currency Unit = Kyrgyz Som (KGS)

USD 1 = KGS 68.4325

## Abbreviations and acronyms

ATM	Automated teller machine
CS-FOR	Carbon Sequestration through Climate Investment in Forests and Rangelands
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
FSP	Financial services provider
GDP	Gross domestic product
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
KGS	Kyrgyz Som (national currency)
KyrSEFF	Kyrgyz Sustainable Energy Finance Facility
MFI	Microfinance institution
NBKR	National Bank of the Kyrgyz Republic
NPL	Nonperforming loans
PIU	Project Implementation Unit
RKDF	Russian-Kyrgyz Development Fund
ROA	Return on assets
ROE	Return on equity
SME	Small and medium-sized enterprise
TA	Technical assistance
USD	United States Dollar
VCF	Value chains financing

## I. Introduction and proposal summary

1. **Component 3 of the Carbon Sequestration through Climate Investment in Forests and Rangelands (CS-FOR): Climate-sensitive Value Chains Development** will support the development of the selected value chains' participants towards higher efficiency and competitiveness of the marketed product. The main selection criteria for the value chains will include low carbon footprint, market potential, financial viability and raw material sourcing area within the core project area (the four districts of Ak-Talaa, Toguz-Toro, Suzak and Uzgen).

2. The Component will also support livestock operations that aim to reduce pressure on pastures and improve their health. The role of the Component is to strengthen the sustainability of the investment in carbon sequestration carried out in Component 2 by creating economic opportunities with limited risk, in order to decrease pressure on and degradation of natural resources in the project intervention areas, thus contributing also to the enhanced resilience. More specifically, Component 3 will focus on decreasing the pressure on pastures by promoting income diversification and more productive livestock generating higher returns.

3. Component 3 will be implemented through the two following sub-components:

(i) **Subcomponent 3.1 Climate-sensitive value chain capacity development.** This subcomponent will focus on capacity development across a number of agricultural value chains. The project will carefully select the value chains contributing to the mitigation of climate-change risks and building the local communities' and market resilience.

(ii) **Subcomponent 3.2 Climate-sensitive value chain financing** will provide financial support to private investment through special credit lines financed by the Russian-Kyrgyz Development Fund (RKDF).

4. The **key activity** under Subcomponent 3.2 will include the activation of special credit lines for project-relevant value chains and entrepreneurs. Supported by the technical assistance provided under Subcomponent 3.1, small and medium enterprises in the project area (as well as other areas with economic connections to the project areas) will have access to the credit lines. The loans will range from USD 10,000 to USD 300,000, with the average amounts about USD 100,000 extended to about 150 end borrowers. The loans will be provided at 5 percent p.a. in USD and at 10 percent in local currency, for a term of about 3-5 years, to existing enterprises representing eligible value chains. Indicative loan purposes include: packaging equipment, equipment for laboratories, vacuum and solar driers, agricultural machinery, greenhouses, eco-tourism, agricultural produce processing etc.

5. **Involved institutions.** The credit line funding will be provided by RKDF through local commercial banks that already reach out to the project target areas.

6. **Indicative outputs and respective targets** will include about 150 entrepreneurs – end borrowers in selected value chains who will access the loans financed by RKDF.

7. The proposed approach of the subcomponent will support the required diversification and enhanced efficiency, productivity and competitiveness of existing economic activities in the highly degraded target areas, based on leveraging available local financial resources and the provision of highly targeted technical assistance to carefully selected value chains.

8. The total estimated value of the Subcomponent is US\$ 16.6 million, including USD 15 million of the RKDF-financed credit line and USD 1.6 million of beneficiaries' contributions.

## II. Country context

### A. Overview of the state of financial inclusion in the Kyrgyz Republic

1. According to G20 Global Partnership for Financial Inclusion, Financial inclusion is measured in three dimensions: (i) access to financial services; (ii) usage of financial services; and (iii) the quality of the products and the service delivery.<sup>1</sup>

2. **Access to financial services.** In terms of physical infrastructure for financial services delivery, Kyrgyzstan is far behind more developed countries. For example, according to the International Monetary Fund (IMF) Financial Access Survey,<sup>2</sup> in 2016 there were 8.38 bank branches in the country per 100,000 adults. To compare, this figure in the neighboring Uzbekistan is 36.14, and in Russia – 30.14 branches per 100,000 adults. Similarly, the number of automated teller machines (ATM) in Kyrgyzstan is relatively low: there are 31.21 ATMs per 100,000 adults in the country as compared to 74 and 168.7 ATMs per 100,000 adults in Kazakhstan and Russia, respectively. Yet Kyrgyzstan is ahead of Uzbekistan, with 21.60 ATMs per 100,000 adults in the latter.

3. **Usage of financial services** (see Table 1 for details). Generally, Kyrgyzstan is characterized by relatively low levels of financial services usage, though significant progress has been achieved in the past years. For example, account ownership<sup>3</sup> in the country reached close to 40 percent by 2017, growing from less than 4 percent in 2011 to over 18 percent in 2014. Yet it is still lower than in the peer countries: this indicator is over 65 percent in Eastern Europe and Central Asia (ECA) and almost 58 percent in lower middle-income countries, respectively, according to the World Bank Global Findex (2018). A specific feature of Kyrgyzstan is that there is virtually no gap in account ownership in terms of gender or urban versus rural areas.

4. The percentage of people saving at a financial institution in Kyrgyzstan decreased from 4.9 percent in 2014 to 3 percent in 2017; this is a very low indicator as compared to 14.4 percent in ECA and 15.9 percent in lower middle-income countries. It should be noted though that there are 9 percent of adults who saved in different ways (both formal and informal) to start a farm or a business in Kyrgyzstan in 2017.

5. However, in the area of formal credit usage the country is slightly ahead of its peers in lower middle-income countries – 10.2 percent of adults used formal credit in the past year versus 9.8 in the middle-income countries, and behind ECA where this figure is higher – 24.2 percent in 2017. Credit usage is slightly higher among rural residents of Kyrgyzstan (close to 11 percent). Overall, as compared to 2014, both formal and informal credit usage in Kyrgyzstan has decreased which may be a sign of credit market stabilization after rapid credit growth in the recent years.

6. The data from the country's Credit Information Bureau "Ishenim" confirms the relatively high usage of credit in the Kyrgyz Republic. According to "Ishenim", the total number of borrowers as of January 2016 was close to 600,000, with about 15 percent of them with parallel loans. This is a significant improvement of the over-indebtedness crisis of 2012 when about 30 percent of borrowers had parallel outstanding loans, often from more than one lender. Table 2 shows trends in parallel loans in 2014 – 2016, and Table 3 – the composition of borrowers with parallel loans as of January 2016.

<sup>1</sup> <http://www.gpfi.org/sites/default/files/G20%20Set%20of%20Financial%20Inclusion%20Indicators.pdf>

<sup>2</sup> [www.data.imf.org](http://www.data.imf.org)

<sup>3</sup> The account penetration level is the indicator commonly used to assess the number of the "banked" people in a country and the level of financial inclusion.

Table 1. Select indicators on financial services usage in Kyrgyzstan and peers, 2011 – 2017

Europe & Central Asia		Lower middle income	
Population, age 15+ (millions)	4.2	GNI per capita (\$)	1,100
	Country data	Europe & Central Asia	Lower middle income
<b>Account (% age 15+)</b>			
All adults	39.9	65.3	57.8
All adults, 2014	18.5	57.8	41.9
All adults, 2011	3.8	44.8	28.9
<b>Financial institution account (% age 15+)</b>			
All adults	38.3	65.1	56.1
All adults, 2014	18.5	57.8	40.6
All adults, 2011	3.8	44.8	28.9
<b>Mobile money account (% age 15+)</b>			
All adults	3.1	3.2	5.3
All adults, 2014	..	0.2	3.2
<b>Account, by individual characteristics (% age 15+)</b>			
Women	38.9	62.5	53.0
Adults belonging to the poorest 40%	35.7	56.3	50.7
Adults out of the labor force	32.8	52.8	50.8
Adults living in rural areas	39.1	61.7	57.6
<b>Digital payments in the past year (% age 15+)</b>			
Made or received digital payments	36.1	60.4	29.2
Made or received digital payments, 2014	14.5	46.1	19.7
Used an account to pay utility bills	18.1	23.0	7.5
Used an account to receive private sector wages	5.2	21.2	5.5
Used an account to receive government payments	13.5	28.8	8.3
Used the internet to pay bills or to buy something online	5.0	30.6	6.8
Used a mobile phone or the internet to access an account	5.8	23.1	8.3
Used a debit or credit card to make a purchase	6.8	38.5	10.0
<b>Inactive account in the past year (% age 15+)</b>			
No deposit and no withdrawal from an account	6.0	6.6	21.6
No deposit and no withdrawal from a financial institution account	6.1	6.7	22.0
<b>Domestic remittances in the past year (% age 15+)</b>			
Sent or received domestic remittances through an account	12.1	12.8	10.1
Sent or received domestic remittances through an OTC service	12.2	7.0	4.7
Sent or received domestic remittances through cash only	8.5	8.0	8.8
<b>Saving in the past year (% age 15+)</b>			
Saved at a financial institution	3.0	14.4	15.9
Saved at a financial institution, 2014	4.9	11.0	14.4
Saved using a savings club or person outside the family	6.0	5.0	13.0
Saved any money	23.7	37.0	39.7
Saved for old age	3.3	15.0	13.2
<b>Credit in the past year (% age 15+)</b>			
Borrowed from a financial institution or used a credit card	10.2	24.2	9.8
Borrowed from a financial institution or used a credit card, 2014	14.7	22.3	10.0
Borrowed from family or friends	16.9	24.5	30.4
Borrowed any money	32.2	44.0	42.9
Outstanding housing loan	8.8	11.6	5.0

Source: World Bank Global Findex (2018).

Table 2. Number of borrowers with parallel loans, 2014 – 2016

Indicator	2014	2015	2016
Number of borrowers with parallel loans	86,893	93,670	82,372
Total number of borrowers	489,363	534,411	552,396
<i>Number of borrowers with parallel loans, %</i>	<i>18%</i>	<i>18%</i>	<i>15%</i>

Source: Credit Information Bureau "Ishenim" (2016).

Table 3. Number of loans per borrower, January 2016

Number of loans per borrower	Number	% of total
1 loan	470,024	85.1%
2 loans	74,370	13.5%
3 loans	7,057	1.3%
4 loans	716	0.1%
5 and more loans	229	0.0%
<b>Total</b>	<b>552,396</b>	<b>100%</b>

Source: Credit Information Bureau "Ishenim" (2016).

7. Borrowers are especially active in using micro and small loans: of all outstanding loans reported to "Ishenim" as of January 2016, 78 percent are below KGS 250,000 (USD 3,650), and 29 percent – below KGS 50,000 (USD 730) – see Table 4.

Table 4. Number of loans by loan size, KGS, January 2016

Loan size	Number	% of total
Below 50,000	171,257	29%
50,000 - 250,000	296,297	49%
250,000 - 500,000	93,035	16%
500,000 - 2,500,000	33,094	6%
Over 2,500,000	5,089	1%
<b>Total</b>	<b>598,772</b>	<b>100%</b>

Source: Credit Information Bureau "Ishenim" (2016).

8. The active usage of micro and small credit has been confirmed during the CS-FOR Project Design Mission in April 2018 at meetings with 4 commercial banks (including one microfinance bank) and the banking and microfinance associations. Micro and small credit is generally available to all clients with a source of income and acceptable credit histories, including for micro and small loans for agriculture which represents a significant portion of banks' portfolios (see below).

9. **Quality of financial products and service delivery.** According to G20 Financial Inclusion Indicators, the dimension of Quality covers the following areas: Financial Knowledge, Financial Behaviour, Disclosure Requirements, Dispute Resolution, Cost of Usage, and Credit Barriers.

10. Kyrgyzstan is characterized by very low levels of financial literacy, per the World Bank/Standard&Poor's Rating Services Global Financial Literacy Survey (2014): only 19 percent of adults were able to respond correctly to questions assessing basic knowledge of four fundamental concepts in financial decision-making: knowledge of interest rates, interest compounding, inflation, and

risk diversification. To compare, the share of financially literate adults in Uzbekistan is 21 percent, in Russia – 38 percent, and in Kazakhstan – 40 percent.<sup>4</sup>

11. A diagnostic review of consumer protection and financial literacy conducted in the Kyrgyz Republic by the World Bank in 2014 recognized the efforts undertaken by the National Bank of the Kyrgyz Republic (NBKR) in the area of regulating and supervising consumer protection requirements (including disclosure and dispute resolution) in relation to banking and microfinance clients, yet noted the need for a more clear mandate for NBKR, as well as the necessity to further streamline and standardize consumer protection regulations, and simplify disclosure requirements for consumers.<sup>5</sup>

12. In the area of Credit Barriers, Kyrgyzstan has shown an improvement by 5 points as compared to 2017 in the Getting Credit indicator and ranks 29th in 2018, according to the World Bank Doing Business 2018 report. This is at the same level as Russia and ahead of Kazakhstan (ranking 77<sup>th</sup>) and Tajikistan (ranking 122<sup>nd</sup>), as well as the regional ECA average of 65.5. (Overall Kyrgyzstan ranks 77th out of the 189 economies surveyed, with no change in the general rank between 2017 and 2018).<sup>6</sup>

13. In particular, Kyrgyzstan scores 6 out of 8 in terms of the Depth of Credit Information Index. The country's Credit Information Bureau "Ishenim" covers over 1.43 million individuals, or 37 percent of the adult population in the country, and 3,743 legal entities in 2017.<sup>7</sup>

14. In terms of the Cost of Usage, while the cost of credit has been slowly declining in the past 5 years, it still remains very high. Per the data from "Ishenim", weighted average interest rates have not changed significantly over the course of the last 5 years, as shown in Table 6.

*Table 6. Weighted average interest rates on credit. 2013 – 2017*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>2013</b>	19.8	19.7	19.5	19.4	19.3	19.2	19.0	18.8	18.7	18.6	18.4	18.4
<b>2014</b>	18.3	18.1	17.9	17.8	17.8	17.6	17.6	17.5	17.5	17.5	17.5	17.6
<b>2015</b>	17.8	17.6	18.8	18.8	18.8	18.7	18.7	18.7	18.8	18.9	18.8	18.9
<b>2016</b>	19.6	19.7	19.6	19.7	19.7	19.5	19.3	19.1	19.0	18.8	18.6	18.3
<b>2017</b>	18.2	18.0	17.7	17.5	17.2	16.9	16.7	16.6	16.5	16.3	16.2	16.0

*Source: Credit Information Bureau "Ishenim" (2018), based on NBKR data.*

15. For local currency loans, the weighted average interest rate in December 2017 was even higher – close to 19 percent, and for foreign currency loans – 11.3 percent. The banks interviewed mentioned a range of 22–37 percent for micro and small loans as typical commercial interest rates offered in the market (Table 7).

*Table 7. Weighted average interest rates on credit, in local and foreign currency. 2017*

Interest rates	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Loans in national currency	22.1	21.9	21.5	21.1	20.7	20.2	19.8	19.7	19.5	19.2	19.1	18.8
Loans in foreign currency	13.3	13.1	12.9	12.7	12.4	12.3	12.1	12.0	11.8	11.7	11.5	11.3

*Source: Credit Information Bureau "Ishenim" (2018), based on NBKR data.*

<sup>4</sup> [http://qflec.org/wp-content/uploads/2015/11/Finlit\\_paper\\_16\\_F2\\_singles.pdf](http://qflec.org/wp-content/uploads/2015/11/Finlit_paper_16_F2_singles.pdf)

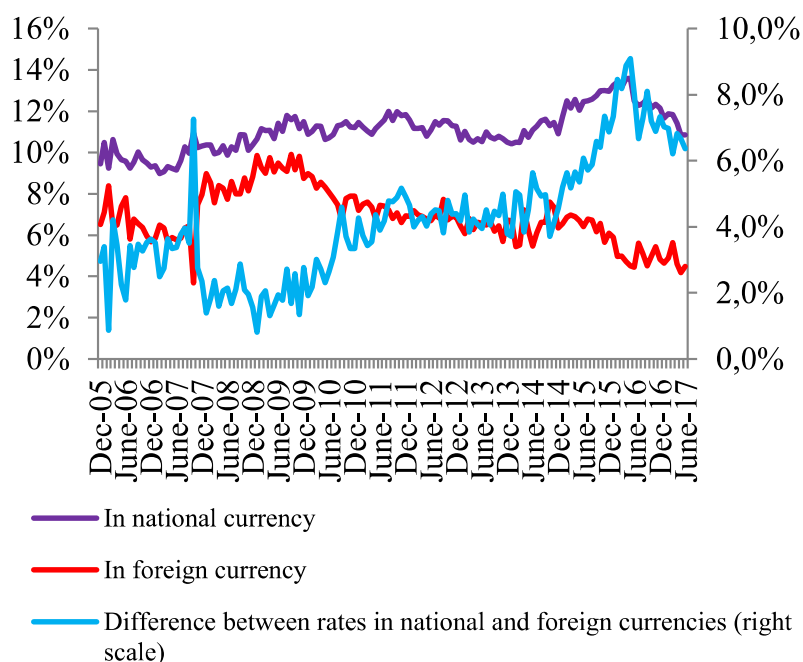
<sup>5</sup> <http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Diagnostic-Reviews/Kyrgyzstan-CPFL-DiagReview-Vol-I-FINAL.pdf>

<sup>6</sup> <http://www.doingbusiness.org/data/exploreeconomies/kyrgyz-republic>

<sup>7</sup> <http://www.doingbusiness.org/data/exploreeconomies/kyrgyz-republic#getting-credit>

16. The high costs of credit are partially due to high cost of funds in Kyrgyzstan. Thus, the NBKR refinancing rate is currently 5 percent p.a.,<sup>8</sup> and the interest rates on retail deposits have been around 10 percent p.a. and higher in local currency, and around 6-8 percent p.a. in foreign currency.

Figure 1. Trends in average weighted interest rate of individuals' time deposits, 2005 – mid-2017.



Source: NBKR 2018.

<sup>8</sup> <http://www.nbkr.kg/newsout.jsp?item=31&lang=ENG&material=84389>



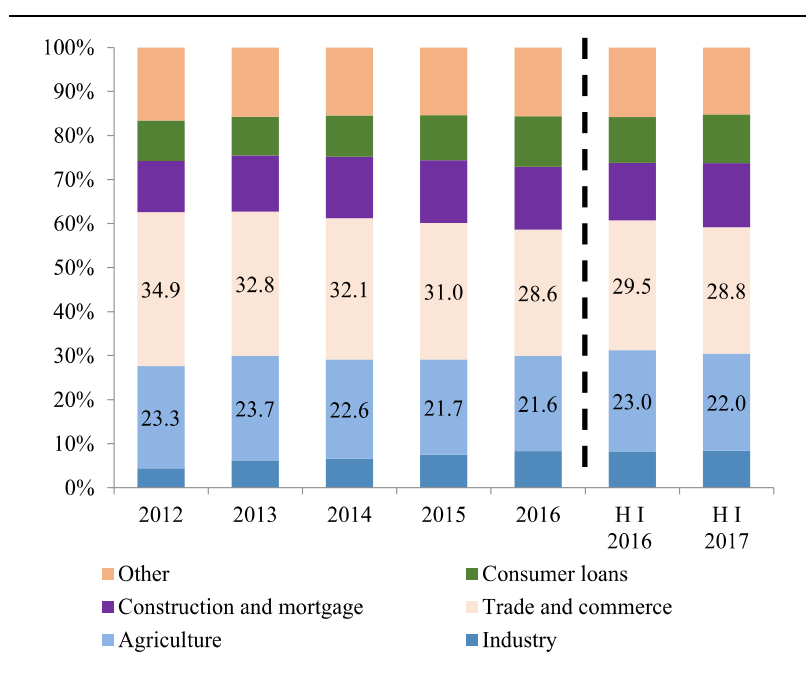
## B. Financial Sector and Agricultural Finance in the Kyrgyz Republic

17. The financial sector in the Kyrgyz Republic includes commercial banks and other financial institutions (nonbank financial institutions (NBFI), insurance companies, investment and pension funds, stock exchanges). The sector<sup>9</sup> is dominated by banks that as of mid-2017, held close to 90 percent of the financial sector portfolio.

18. As of mid-2017, the assets of the banks and nonbank financial institutions constituted KGS 197.8 billion (USD 2.9 billion) or 42.0 percent of the country's gross domestic product (GDP). The total loan portfolio of the banks and nonbanking financial institutions was KGS 113.6 billion (USD 1.66 billion) or 24.1 percent of GDP.

19. The share of agriculture in the structure of the financial sector's loan portfolio has been stable over the past 6 years, ranging between 21.6 and 23.3 percent and being the second most funded economic sector after trade (Figure 2).

Figure 2. Financial sector loan portfolio breakdown by economic sectors, 2012-mid-2017.



Source: NBKR 2018.

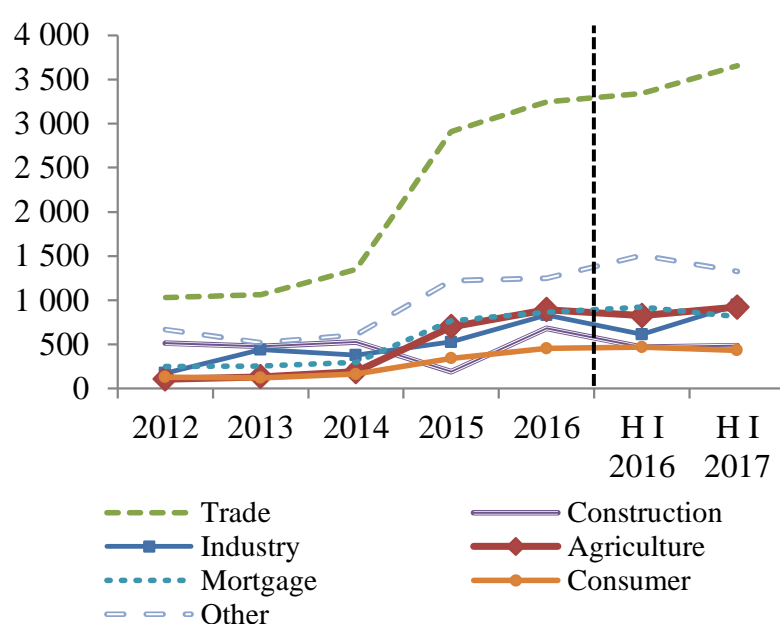
20. **Banking sector.** As of mid-2017, there were 25 commercial banks in Kyrgyzstan working through 319 branches. Assets of the banking sector by mid-2017 amounted to KGS 183.8 billion (USD 2.7 billion), having increased by 5.2 percent compared with the first half of 2016. For the same period, the liabilities of the banking sector amounted to KGS 154.2 billion (USD 2.23 billion), having increased by 4.4 percent as compared to mid-2016. The growth of liabilities was primarily due to the growth of the retail and non-financial enterprises' deposit base which grew by 16.2 percent from mid-2016 to mid-2017 and amounted to KGS 103.4 billion (USD 1.5 billion). The share of retail and non-financial enterprises' deposits in the banks' liabilities amounted to 67.1 percent in June 2017.

<sup>9</sup> Unless otherwise noted, all data in this section is based on NBKR data. See: "The Financial Sector Stability Report of the Kyrgyz Republic." November 2017.

21. The banking sector of the country is relatively stable and profitable. Between mid-2016 and mid-2017, the return on equity (ROE) of the banking sector was 0.7 percent, and the return on assets (ROA) – 4.5 percent. The net profit of the banking sector amounted to KGS 633.1 million (USD 9.3 million) over this period. The capital to risk-weighted asset ratio was 24 percent as of June 2017, remaining well above the prudential minimum threshold of 12 percent and having increased by 0.5 p.p. as compared with the first half of 2016.

22. In terms of the credit risk, the share of nonperforming loans in the loan portfolio of banks decreased from 9.0 percent in June 2016 to 8.4 percent by June 2017. The highest concentration of credit risks was still observed in the trade sector of economy while the share of nonperforming loans in the agricultural sector remained relatively low and stable (Figure 3).

Figure 3. Volume of nonperforming loans by sectors of economy, KGS million. 2012 – mid-2017.



Source: NBKR 2018.

23. As noted above, the banking sector is heavily focused on agriculture and on reaching small and micro businesses. There is a government “Financing Agriculture” program of providing interest rates subsidies for agricultural loans issued through commercial banks at 6 to 10 percent per annum.<sup>10</sup> In 2017, about 10,000 such loans were disbursed to farmers through 6 commercial banks.<sup>11</sup> In 2018, over KGS 1 billion (USD 14.7 million) was allocated for such subsidies.<sup>12</sup>

24. The largest agricultural lender in Kyrgyzstan is **Ayil Bank**, fully owned by the government, with assets over USD 308 million as of December 2017 and a loan portfolio of close to USD 221 million.<sup>13</sup> The bank currently has about 63 percent of its portfolio in agriculture, including leasing of agricultural machinery (Figure 4). It works through its 190 branches all over the country (60 percent of all bank branches in the country).

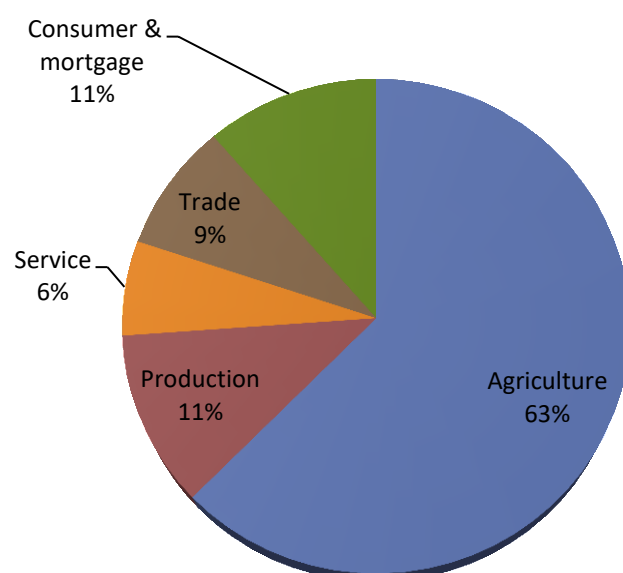
<sup>10</sup> <http://cbd.minjust.gov.kg/act/view/ru-ru/98762>

<sup>11</sup> [http://mineconom.gov.kg/index.php?option=com\\_content&view=article&id=5858&catid=63&lang=ru](http://mineconom.gov.kg/index.php?option=com_content&view=article&id=5858&catid=63&lang=ru)

<sup>12</sup> [https://24.kg/ekonomika/75022\\_subsidirovanie\\_selskohozyaystvennoy\\_otrasli\\_kyrgyzystana\\_uvelichitsya/](https://24.kg/ekonomika/75022_subsidirovanie_selskohozyaystvennoy_otrasli_kyrgyzystana_uvelichitsya/)

<sup>13</sup> All data on Ayil Bank is based on information provided by Ayil Bank.

Figure 4. Ayil Bank's portfolio breakdown by sector, December 2017.



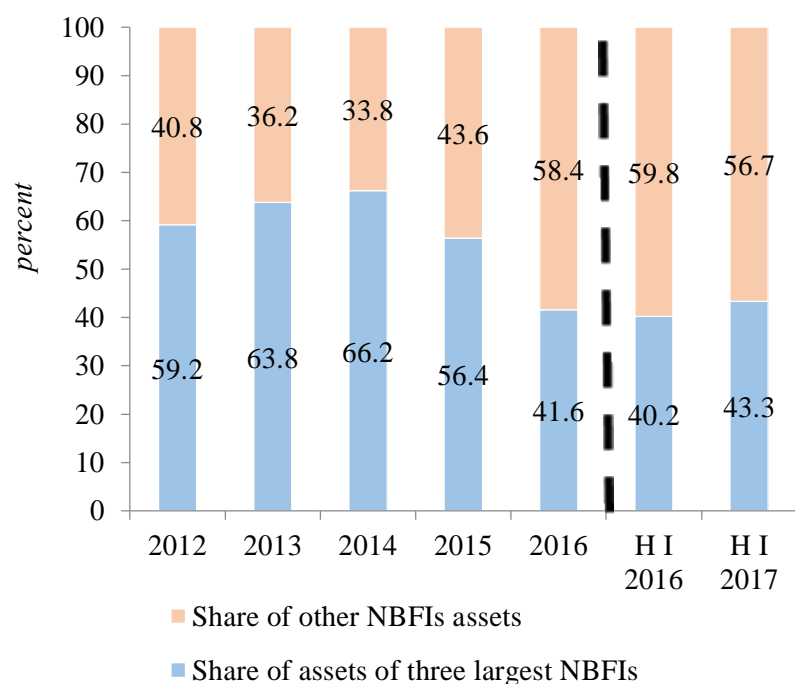
Source: Ayil Bank 2018.

25. Ayil Bank currently serves over 60,000 active borrowers, with the average loan amount of USD 3,539. Since 2011, the bank has leased over 1,900 units of agricultural machinery worth over USD 15 million. Ayil Bank has been an active participant of the government's "Financing Agriculture" program providing interest rates subsidies, as noted earlier. Since 2012, Ayil Bank has disbursed subsidized loans under this program for an amount over USD 148 million (including the amount committed to disbursement in 2018).

26. Ayil Bank has also been implementing a socially responsible project for financing low-income families throughout the country, providing more than 25,000 loans annually for the total amount of over USD 13 million. The maximum loan amount for this program is USD 735, disbursed for a period of up to 12 months at 10 percent p.a.

27. **Non-bank financial institutions (NBFI).** The non-bank lenders in Kyrgyzstan include 159 microfinance organizations (including 6 microfinance companies, 101 microcredit companies and 52 microcredit agencies) and 114 credit unions. The total assets of NBFIs in June 2017 increased by 6.2 percent and amounted to KGS 13,972.5 million (USD 206 million) due to the growth in the NBFIs' loan portfolio. The NBFI sector is heavily concentrated: there are three largest microfinance institutions (MFIs) that account for over 43 percent of the sector assets (Figure 5).

Figure 5. Distribution of NBFI assets, 2012 – mid-2017.

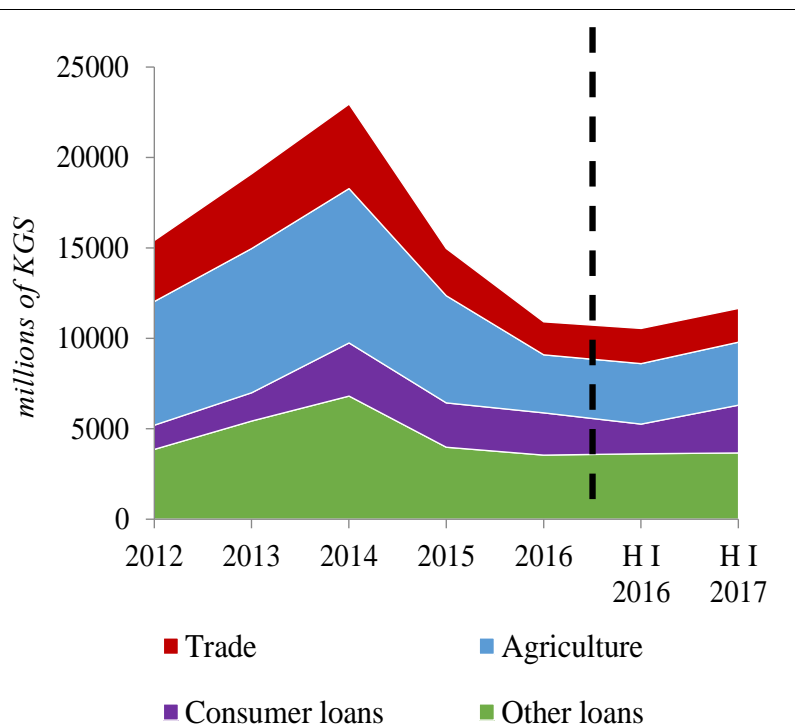


Source: NBKR 2018.

28. The main activity of NBFIs is lending. As of June 30, 2017, the loan portfolio of NBFIs increased by 10.5 percent as compared to the year before and reached KGS 11,648.6 million (USD 171 million). The number of NBFIs' borrowers increased by 5.4 percent compared with June 2016 and reached 238,654. Thus, the average loan balance of NBFIs amounted to about USD 716. The main oblasts where the major share of loan portfolio of NBFIs is concentrated (78.3 percent of total credit portfolio) are Bishkek city, Chui, Osh and Jalal-Abad oblasts, which is due to the highest level of business activity in these oblasts of the republic.

29. NBFIs loan portfolio is concentrated in agriculture (29.9 percent of NBFIs' total loans), trade and consumer loans (16 percent and 22.7 percent of the total loan portfolio, respectively) (Figure 6).

Figure 6. NBFIs loan portfolio breakdown by sector, 2012 – mid-2017.

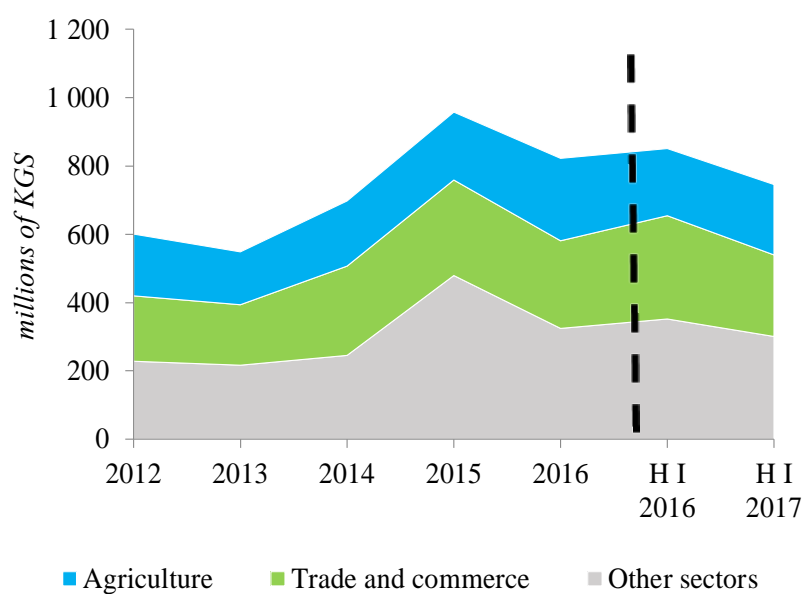


Source: NBKR 2018.

30. Overall, the performance of non-banks in 2015 can be characterized as moderately stable. At the end of the first half of 2017 the net profit of NBFIs increased by 7.6 percent as compared to the first half of 2016 and amounted to KGS 540.3 million (USD 7.9 million). ROA at the end of the reporting period increased by 0.9 p.p. and amounted to 4.0 percent; ROE increased by 0.5 p.p. and reached 6.3 per cent.

31. The quality of the NBFIs' loan portfolio is generally higher than that of the banking sector: in June 2017 it stood at the level of 6.4 percent; within the nonperforming loans, the share of loans to agriculture grew by 4.6 p.p. compared to the year before, but still remains the smallest portion of the NPLs as compared to trade and commerce and other sectors (Figure 6).

Figure 6. Structure of NBFIs nonperforming loans by sectors of economy, 2012 – mid-2017.



Source: NBKR 2018.

### C. “Green” Agriculture Support Projects in the Kyrgyz Republic

32. Several international and domestic funders are currently implementing or considering projects aimed at the development of agriculture in the Kyrgyz Republic, but few are working in the area of “green” finance. Those most relevant to CS-FOR’s Component 3 include (alphabetically):

- (a) European Bank for Reconstruction and Development (EBRD);
- (b) Russia-Kyrgyz Development Fund.

33. **EBRD.** In 2015, EBRD launched the Green Economy Transition approach<sup>14</sup> aimed at increasing the volume of sustainable financing by focusing on investments that bring environmental benefits. Under this framework, EBRD launched a USD 20 million facility in April 2013 – the Kyrgyz Sustainable Energy Finance Facility (KyrSEFF) as one of the Sustainable Energy Financing Facilities of EBRD. KyrSEFF financing included grants of up to 10-35 percent of project cost from the European Union’s Investment Facility for Central Asia.<sup>15</sup>

34. In November 2016, EBRD launched the extension of KyrSEFF – KyrSEFF+. This is a USD 35 million financing program that works under similar conditions and includes both grants and loans disbursed through local partner banks. KyrSSEFF+ loans are supported by grants incentives of up to 35 percent as well as technical assistance. As of April 2018, there are 6 banks taking part in the facility.<sup>16</sup>

35. The services of the KyrSSEFF+ facility are available to:

- (a) Private households, owners of houses and apartments and residential buildings for investments in energy and water saving technologies. Investments may range from wall insulation through to innovative solar energy and rainwater harvesting solutions, allowing families to save money and increase the comfort of their homes.
- (b) Private enterprises in industry, agribusiness and service sectors for investments that result in energy, water and other resource savings. These investments may include new efficient machinery for production companies, compact waste-water treatment systems and energy saving devices for hotels, drip irrigation and machinery for agricultural companies, etc.
- (c) Suppliers, vendors and installers of energy and resource efficient technologies to ensure these are readily available in Kyrgyzstan. Investments may include an expansion of stock holding, the operating base, etc.

36. The sectors and energy efficient technologies covered by KyrSEFF and KyrSEFF+ include:

- (a) Agribusiness: tractors, harvesters, working trailers, irrigation systems, grain/fruit/vegetable dryers.
- (b) Greenhouses: ventilation systems, heating systems, energy efficiency glazing.
- (c) Buildings: air conditioning, boilers, lighting, windows and glazing, insulation materials, household appliances.
- (d) Construction: conveyors, generation sets, drilling machines, soil compactors.
- (e) Textile: washing systems, drying units, air compressors, textile machines.
- (f) Food processing: baking equipment, freezing technologies.

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<sup>14</sup>

<http://www.ebrd.com/cs/Satellite?c=Content&cid=1395250237163&d=Mobile&pagename=EBRD%2FContent%2FContentLayout>

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<http://www.ebrd.com/cs/Satellite?c=Content&cid=1395253733728&d=Mobile&pagename=EBRD%2FContent%2FContentLayout>

<sup>16</sup> <http://www.kyrseff.kg/green-trade-finance-for-suppliers/?lang=en>

37. **The Russian-Kyrgyz Development Fund (RKDF)** was established in late 2014 as an international organization per the Agreements between the governments of the Kyrgyz Republic and the Russian Federation “On the development of economic cooperation in the conditions of Eurasian economic integration” and “On the Russian-Kyrgyz Development Fund”.<sup>17</sup> The capital of the Fund is USD 500 million.

38. RKDF provides both direct funding to Kyrgyz medium-sized and large enterprises (with loans starting from USD 1 million) and indirectly through commercial banks to smaller enterprises (loans below USD 1 million). RKDF lends to all economic sectors and as of April 2018, has funded 926 enterprises for a total amount of over USD 275 million.<sup>18</sup>

39. Agriculture is one of the key focus areas for RKDF: it takes the first place in terms of the number of loans (338 out of 926, or 36.5 percent) and second in terms of the volume of funding (over USD 64 million, or 23 percent). In 2016, RKDF has partnered with International Fund for Agricultural Development (IFAD) to provide loans to agricultural producers and processors identified and assisted through IFAD’s “Access to Markets Programme” in Kyrgyzstan, to be launched later in 2018. RKDF has also expressed interest in partnering with CS-FOR by providing a credit line for project beneficiaries in the amount of USD 15 million.

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<sup>17</sup> [http://www.rkdf.org/o\\_nas/obschaja\\_informatsija/informatsija\\_o\\_fonde](http://www.rkdf.org/o_nas/obschaja_informatsija/informatsija_o_fonde)

<sup>18</sup> [http://www.rkdf.org/ru/o\\_nas/otchetv](http://www.rkdf.org/ru/o_nas/otchetv)



## V. Recommendations

### A. Rationale

40. The agricultural sector plays an important role in the economy and society of the Kyrgyz Republic; this role is reflected in the financial sector loan portfolio, with agriculture being the second largest funded economic sector that has been taking up a consistent share over the past years (between 21 and 23 percent of the total loan portfolio). The existing financial services providers (FSP) and government programs have been focusing both on the agricultural sector as well as micro and small businesses: as noted above, there are over 283 thousand microfinance borrowers served by MFIs with average loan balances of USD 716; the largest agricultural bank in the country, Ayil Bank, serves over 60 thousand active borrowers with an average loan amount of USD 3,539 and issues about 25,000 loans annually to socially vulnerable categories, with amounts up to USD 735. Overall, close to 80 percent of all loans in the country are below USD 3,650, including 29 percent – below USD 730.

41. Therefore, the niche of micro and small agricultural loans appears to be well covered by the existing lending programs of the government and commercial banks, and no additional loan funding will be necessary for this category.

42. It appears that there may be a financing gap in the area of medium-sized and larger loans for agricultural producers and processors.<sup>19</sup> The banks interviewed mentioned that they have few loans in this category, and often due to the limitations of the government-funded interest rates subsidies it is not possible to reach this category with soft loans.

43. According to the Ministry of Agriculture and Melioration, there is a need for replacing old agricultural machinery and equipment whose amortization level is about 90 percent. In addition, over 15,000 new machinery and equipment units are needed. The investment necessary for this is estimated at the level of USD 500 million.<sup>20</sup> The need for agricultural machinery is partially being met by Ayil Bank's leasing program that has leased over 1,900 machinery units since 2011 and became the largest player in the leasing market, as described earlier. There are six other banks offering leasing services, but their aggregate share of the leasing market is small (about 6 percent).<sup>21</sup>

44. There are several funders currently engaged or planning to engage in agriculture support in Kyrgyzstan, including through the provision of credit lines of significant volumes (for example, the funding available from the Russian-Kyrgyz Development Fund alone equals to some 43 percent of the total outstanding loan portfolio of the whole financial sector).

45. CS-FOR will partner with RKDF and financial services providers (FSP) with the goal of linking eligible project beneficiaries to credit resources, to ensure the complementarity of the interventions and to scale up the technical assistance investment into agricultural value chains under the project.

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<sup>19</sup> It appears there has been no comprehensive national market research done in Kyrgyzstan on the funding needs of the agricultural sector.

<sup>20</sup> [http://agroinfo.com/wp-content/uploads/2013/05/Appendix\\_On\\_the\\_demand.pdf](http://agroinfo.com/wp-content/uploads/2013/05/Appendix_On_the_demand.pdf)

<sup>21</sup> [http://www.senti.kg/article/lizing\\_v\\_kirgizctane\\_utopiya\\_ili\\_realnoct](http://www.senti.kg/article/lizing_v_kirgizctane_utopiya_ili_realnoct)

## B. Objective

46. The primary objective of Subcomponent 3.2: Climate-sensitive Value Chains Sustainable Financing will be to increase access to finance for small, medium-sized and larger agricultural producers and processors within eligible value chains working in (or connected with) the target project areas, where there is currently a funding gap, by linking them with an external credit line provided by RKDF, in order to improve their efficiency and competitiveness. This would eventually contribute to decreasing pressure on and degradation of natural resources in the project intervention areas, thus contributing also to the enhanced resilience.

47. The main selection criteria for the value chains will include low carbon footprint, market potential, financial viability and raw material sourcing area within the core project area (the four districts of Ak-Talaa, Toguz-Toro, Suzak and Uzgen).

## C. Description of Activities

9. The **key activity** under Subcomponent 3.2 will include the activation of special credit lines for project-relevant value chains and entrepreneurs. Supported by the technical assistance provided under Subcomponent 3.1, small, medium and larger enterprises in the project area (as well as other areas with economic connections to the project areas) will have access to the credit lines. The loans will range from USD 10,000 to USD 300,000, with the average amounts about USD100,000 extended to about 150 end borrowers. The loans will be provided at 5 percent p.a. in USD and at 10 percent in local currency, for a term of about 3-5 years, to existing enterprises representing eligible value chains. Indicative loan purposes include: packaging equipment, equipment for laboratories, vacuum and solar driers, agricultural machinery, greenhouses, eco-tourism, agricultural produce processing etc.

10. **Involved institutions.** The credit line funding will be provided by RKDF through local commercial banks that already reach out to the project target areas. Preliminarily, 5 commercial banks will participate in the disbursement of the credit line (listed alphabetically):

- (i) Ayil Bank;
- (ii) Bank Kyrgyzstan;
- (iii) BTA Bank;
- (iv) Kompanion Bank; and
- (v) RSK Bank.

11. The project will work in close collaboration with RKDF and the partner banks to identify prospective beneficiaries within the eligible value chains and ensure the complementarity of the technical assistance provided under Subcomponent 3.1 and credit resources under Subcomponent 3.2.

12. **Indicative outputs and respective targets** will include about 150 entrepreneurs – end borrowers in selected value chains who will access the loans financed by RKDF.

13. The proposed approach of the subcomponent will support the required diversification and enhanced efficiency, productivity and competitiveness of existing economic activities in the highly degraded target areas, based on leveraging available local financial resources and the provision of highly targeted technical assistance to carefully selected value chains.

48. The total estimated value of the Subcomponent is US\$ 16.6 million, including USD 15 million of the RKDF-financed credit line and USD 1.6 million of beneficiaries' contributions.

## **D. Implementation arrangements**

49. The Project Implementation Unit (PIU) to be established for CS-FOR APIU will recruit a Value Chains Financing (VCF) Specialist to oversee the activities under Subcomponent 3.2.

50. The VCF Specialist will work in close collaboration with RKDF and the partner banks to identify prospective beneficiaries within the eligible value chains and ensure the complementarity of the technical assistance provided under Subcomponent 3.1 and credit resources under Subcomponent 3.2.

51. The selection of partner banks will also be the responsibility of RKDF. The VCF Specialist will not interfere with RKDF or partner banks' lending policies and procedures.

52. Based on preliminary agreement with RKDF, the VCF Specialist may be based in the RKDF office which will facilitate the communication with RKDF and ensure better connection between Subcomponents 3.1 and 3.2.

## **E. Benefits and Beneficiaries**

53. Component 3 will support the development of the selected value chains' participants towards higher efficiency and competitiveness of the marketed product. The main selection criteria for the value chains will include low carbon footprint, market potential, financial viability and raw material sourcing area within the core project area (current or planned). Examples, *inter alia*, include tree nuts (walnuts, almonds, pistachio), dried fruits (dried apricot, dried plum), and fruit orchards (cherries, apples). By implementing innovative climate-smart agricultural practices, value addition must be achieved using resource-efficient technologies such as solar dryers, drip irrigation, solar pumps, no-till technique, etc. The Component will also support livestock operations that aim to reduce pressure on pastures and improve their health (e.g., apiculture, rational feeding practices). Necessary investment and technical assistance to ensure compliant slaughter of animals will be supported by IFAD's "Access to Markets Programme".

54. The role of the Component is to strengthen the sustainability of the investment in carbon sequestration carried out in Component 2 by creating economic opportunities with limited risk, in order to decrease pressure on and degradation of natural resources in the project intervention areas, thus contributing also to the enhanced resilience. More specifically, Component 3 will focus on decreasing the pressure on pastures by promoting income diversification and more productive livestock generating higher returns.

55. Subcomponent 3.2 will provide about 150 loans to project-relevant value chains and entrepreneurs ranging from USD 10,000 to USD 300,000, with the average amounts about USD100,000. The loans will be provided at soft conditions: 5 percent p.a. in USD and at 10 percent in local currency, for a term of about 3-5 years.

56. Subcomponent 3.2 will also contribute to building the capacity of both RKDF and partner banks in terms of identification and funding of "green" agricultural value chains, potentially leading to the development of specialized products for this purpose.

57. The proposed approach of the subcomponent will support the required diversification and enhanced efficiency, productivity and competitiveness of existing economic activities in the highly degraded target areas, based on leveraging available local financial resources and the provision of highly targeted technical assistance to carefully selected value chains.

## **F. Risks and Mitigation**

58. The main risks for the Component include:

- (a) Saturation of the agricultural lending market when expected disbursement rates by RKDF and partner banks may not be possible;

- (b) Low skills and capacity of RKDF and partner banks in “green” agrilending and value chain finance. This risk will be addressed by the close interaction with Subcomponent 3.1 and collaboration with RKDF and partner banks in identification of the beneficiaries.
- (c) Use of subsidized resources provided by RKDF which present a risk to the sustainability of the project intervention.

## **G. Sustainability**

59. Sustainability factor is built into the design of the project:

- (a) The project will partner with the existing domestic funder and partner banks interested in the development of the “green” agricultural sector;
- (b) The project will ensure complementarity of technical assistance and credit resources provided to the eligible value chains and enterprises;
- (c) The project will explore new frontiers in the agricultural lending product development in cooperation with interested FSPs and share these learnings among FSPs interested in scaling up these products.

60. As mentioned above, use of subsidized resources provided by RKDF presents a risk to the sustainability of the project intervention. The technical assistance provided under Subcomponent 3.1 should contribute to the mitigation of this risk by supporting the development of the competitiveness of the selected value chains.

## H. Monitoring and Evaluation Indicators

61. The progress in achieving the goal of the Subcomponent will be monitored using the following performance indicators:

At the level of partner banks	<p>Monthly, disaggregated by bank on the basis of gender, region, type of beneficiary and activity:</p> <ul style="list-style-type: none"> <li>• Total number of active borrowers</li> <li>• Total value of gross loan portfolio (in USD)</li> <li>• Average loan amount (in USD)</li> <li>• Average loan term (in months)</li> </ul> <p>Monthly: Portfolio at risk over 30 days (for the Project portfolio) Write-off rate (for the Project portfolio)</p>
At the Project Implementation Unit level (in collaboration with RKDF – using RKDF monitoring systems)	<p>Monthly: Total number of participating banks Total number of referrals to banks (by Subcomponent 3.1) Total number of referrals funded by banks and as percentage of total referrals</p> <p>Quarterly: Disbursed in quarter, by bank and total (value and number of loans)</p> <p>Monthly, Project to date: Disbursed, by bank and total Outstanding portfolio, by bank and total Total number of active borrowers</p> <p>Total number of new products developed</p>

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## Attachment I. Draft Terms of Reference for Value Chains Financing (VCF) Specialist

Position: CS-FOR VCF Specialist

Location: Bishkek

Reporting to: PIU Director

**Component 3 of the Carbon Sequestration through Climate Investment in Forests and Rangelands (CS-FOR): Climate-sensitive Value Chains Development** will support the development of the selected value chains' participants towards higher efficiency and competitiveness of the marketed product. The main selection criteria for the value chains will include low carbon footprint, market potential, financial viability and raw material sourcing area within the core project area (the four districts of Ak-Talaa, Toguz-Toro, Suzak and Uzgen).

The Component will also support livestock operations that aim to reduce pressure on pastures and improve their health. The role of the Component is to strengthen the sustainability of the investment in carbon sequestration carried out in Component 2 by creating economic opportunities with limited risk, in order to decrease pressure on and degradation of natural resources in the project intervention areas, thus contributing also to the enhanced resilience. More specifically, Component 3 will focus on decreasing the pressure on pastures by promoting income diversification and more productive livestock generating higher returns.

Component 3 will be implemented through the two following sub-components:

- (i) **Subcomponent 3.1 Climate-sensitive value chain capacity development.** This subcomponent will focus on capacity development across a number of agricultural value chains. The project will carefully select the value chains contributing to the mitigation of climate-change risks and building the local communities' and market resilience.
- (ii) **Subcomponent 3.2 Climate-sensitive value chain financing** will provide financial support to private investment through special credit lines financed by the Russian-Kyrgyz Development Fund (RKDF).

The CS-FOR Project Implementation Unit (PIU) is requesting the services of a VCF Specialist to coordinate the activities of the Climate-sensitive Value Chain Financing subcomponent.

The suitable candidate will have the following background and experience:

### **Educational Background:**

- Diploma in economics/banking/finance.

### **Experience:**

- Minimum 5 years working experience in the financial sector (banking or microfinance).
- Minimum 3 years practical working experience with economics and financial analysis.
- Computer literacy and proficiency (word processing, spread sheets and data bases).
- Strong verbal and written communication skills.
- Ability to work efficiently under pressure and to meet deadlines.

- Well-organised and well oriented to details.
- Knowledge and experience in agriculture, sociology, market research and statistics is a plus.

**Duties and Responsibilities include, but are not limited to:**

- Setting-up and maintaining databases for external partner institutions and end-borrowers in accordance with the project design and in coordination with RKDF.
- Creating and maintaining customer files and documents on the basis of information received from Subcomponent 3.1 of the project.
- Conduct periodic monitoring of clients funded by external partner institutions (banks).
- Managing portfolio reporting activities with external partner institutions (banks).
- Developing and sharing lessons learnt, monitoring feedback and uptake, and developing reports on dissemination and uptake.
- Preparing periodic reports in accordance with project procedures.