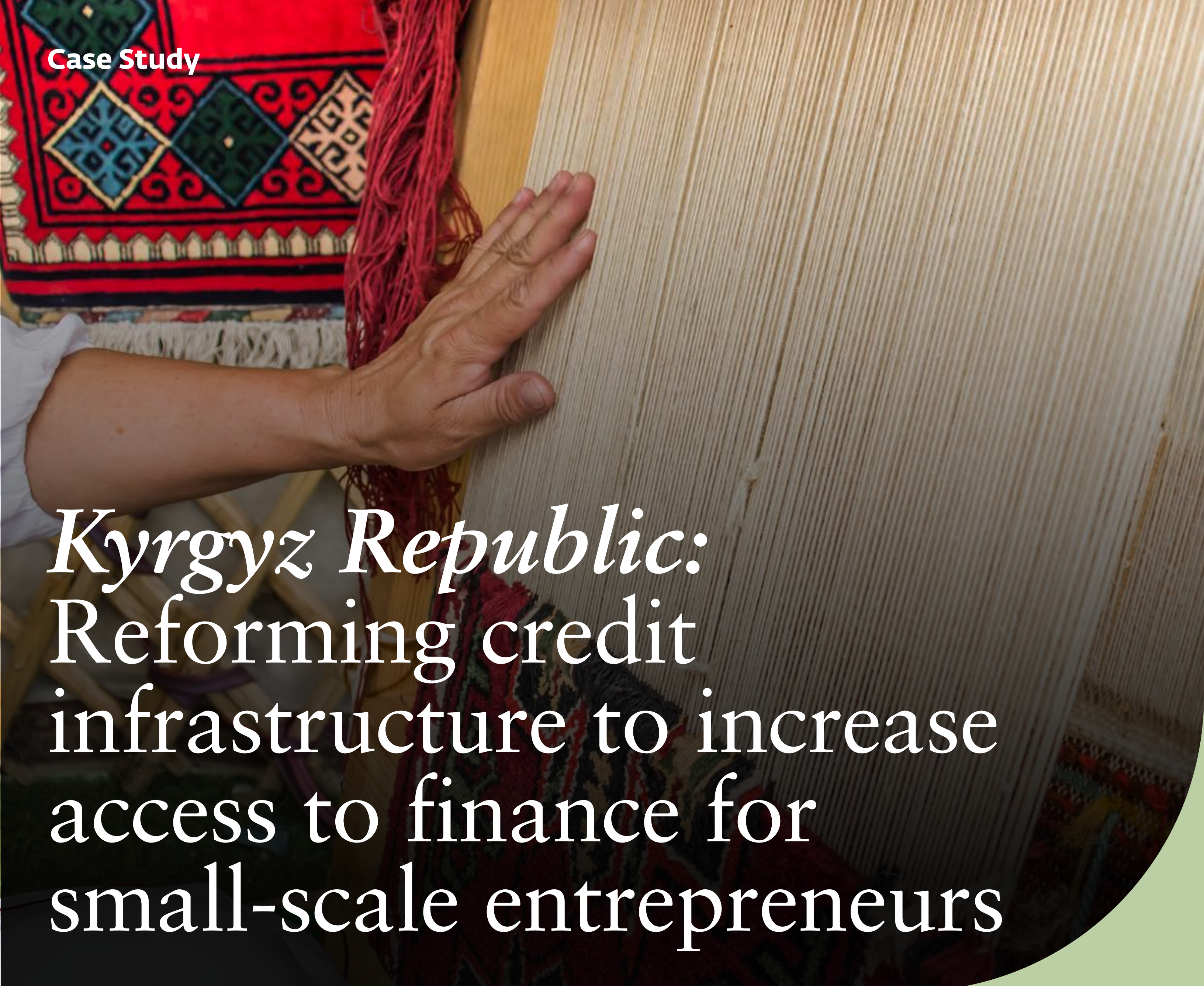

Case Study

Kyrgyz Republic: Reforming credit infrastructure to increase access to finance for small-scale entrepreneurs

September 2024

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO

IFC International Finance Corporation
WORLD BANK GROUP

The material in this work is copyrighted.

Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. IFC does not guarantee the accuracy, reliability or completeness of the content included in this work, or for the conclusions or judgments described herein, and accepts no responsibility or liability for any omissions or errors (including, without limitation, typographical errors and technical errors) in the content whatsoever or for reliance thereon.

The findings, interpretations, views, and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the Executive Directors of the International Finance Corporation or of the International Bank for Reconstruction and Development (the World Bank) or the governments they represent.

© International Finance Corporation. September 2024.
Some rights reserved.

About IFC

IFC — a member of the World Bank Group — is the largest global development institution focused on the private sector in emerging markets. We work in more than 100 countries, using our capital, expertise, and influence to create markets and opportunities in developing countries. In fiscal year 2024, IFC committed a record $56 billion to private companies and financial institutions in developing countries, leveraging private sector solutions and mobilizing private capital to create a world free of poverty on a livable planet. For more information, visit www.ifc.org.

About SECO

The State Secretariat for Economic Affairs (SECO) implements Switzerland's economic and trade policy measures for the benefit of developing countries. It coordinates its activities with the Swiss Agency for Development and Cooperation (SDC) and the Peace and Human Rights Division (PHRD) of the FDFA. The three administrative offices implement Switzerland's international cooperation together. For more information, visit www.seco-cooperation.ch

Introduction

From 2009 to 2019, IFC and the Swiss State Secretariat for Economic Affairs, SECO, collaborated to support the Kyrgyz Republic in upgrading and modernizing its credit infrastructure to increase access to finance for micro, small and medium enterprises (MSMEs). This project was part of the Global Financial Infrastructure Program, a long running partnership of IFC and SECO to accelerate financial inclusion in emerging markets.

In 2009, when IFC and SECO set out to assist the Kyrgyz Republic in building a robust modern credit infrastructure, about a quarter of MSMEs in the country cited lack of access to finance as a major constraint in operating and growing their businesses. This can be compared to 16.6 percent on average across the Europe and Central Asia region. Since declaring independence from the Soviet Union in 1991, the Kyrgyz Republic has pursued a course of democratic and economic reforms marked by uneven progress and periodic political instability. The economy is heavily dependent on remittances from Kyrgyz individuals working abroad, and commodity exports, particularly gold, making it highly vulnerable to external shocks.

The MSME sector is critical to innovation, job creation, and inclusive economic growth. The project thus set out to help reform Kyrgyz Republic's credit infrastructure to enhance access to finance, promote financial stability, and advance sustainable economic growth. Credit infrastructure consists of a set of laws and institutions enabling individuals and enterprises to secure lending from financial institutions based on their credit histories or pledging their movable property, such as machinery, inventory, or receivables as collateral. This framework also enhances financial stability through diversification of financial products, services, and improved management of credit risk.

Key Achievements:

- Facilitated over $5.3 billion in financing for more than 4.6 million individuals and MSMEs by 2023.
- Successfully spearheaded legislative reforms that laid the foundation for a modern credit reporting system and collateral registry, significantly expanding access to finance for individuals and MSMEs and strengthening the capabilities of financial institutions to assess and manage credit risk.
- Introduced financial literacy programs across the country in collaboration with commercial financial institutions and regulating authorities that reached nearly 470,000 individuals.
- Laid the foundation for digitalized processes for credit information sharing and the collateral registry, potentially paving the way for future credit innovation to further enhance access to finance.

By 2023, private sector credit had grown to 21.1 percent of gross domestic product (GDP) compared to 12.5 percent in 2009. There were two fully operational and commercially viable credit bureaus and an improved and modernized collateral registry enabling increased access to finance for individuals and MSMEs. The new credit bureaus facilitated $5.22 billion in financing for 4.5 million individuals and MSMEs. The modernized and digitalized collateral registry enabled 95,700 MSMEs to secure $305 million in financing.

Reforming Nascent Credit Infrastructure: A Phased Approach

The project, part of the Regional Program for Azerbaijan and Central Asia Financial Infrastructure (ACAFI), operated from 2009 to 2019 with a budget of $2.6 million in the Kyrgyz Republic alone. Through the project, IFC equipped relevant public and private sector entities with the expertise needed to develop modern credit infrastructure in the form of a fully functioning and commercially viable private credit bureau and a modernized collateral registry. The program relied on a programmatic approach in three phases that included the passage of enabling legislation, prioritized systemic solutions, and provided the required capacity-building to ensure effective utilization of credit bureaus and the collateral registry. While the project achieved greater success in enhancing the credit reporting system, delays in initiating the collateral registry project impacted its outcomes on that front.

When IFC and SECO intervened in 2009, the credit reporting system consisted of a not-for-profit credit bureau with limited technical and operational capabilities, making it unsustainable in the long term. There was no legislation governing the credit reporting system, including the absence of data protection legislation related to credit information regulation. This legal framework deficiency prevented the credit bureau from becoming commercially viable and attractive for further investments. A diagnostic study conducted by the project team in 2010 highlighted multiple deficiencies in the existing credit bureau's business model, including inefficient corporate governance and organizational structures, poorly defined and cumbersome internal processes and procedures, fragmented and incomplete data, and a lack of commercial incentives for sustainable development. While there was a legal framework for secured transactions in place, it was inadequate and performing poorly.

Phase 1: Legislative Framework

Given that an efficient credit reporting system is anchored in legislation, the project began by establishing the framework of rules and rights of public and private stakeholders involved. To that end, the project organized a study tour for sector representatives to Morocco, leveraging IFC's successful experience collaborating with the central bank of Morocco, Bank Al-Maghrib, on credit information exchange, credit bureau formation, and instituting regulatory reforms. This set the stage for the reform process in the Kyrgyz Republic, galvanizing support for the reform process from key stakeholders. Despite political turbulence leading to the abandonment of legislative reforms three times, the Law on Credit Information Sharing was passed in 2016. This legislative milestone, coupled with related acts, laid the foundation for sustainable data sharing practices. The project also launched legislative reform on secured transactions, allowing for the unlimited use of movable property as collateral for loans and thereby expanding potential credit options for small and medium enterprises. This reform resulted in the adoption of nine legislative acts, including the Law on Collateral and the Civil Code.

Phase 2: Building Infrastructure

The second phase of the project sought to modernize the existing credit bureau and collateral registry. A cornerstone of the project was the transformation of the existing not-for-profit credit bureau into a commercial entity, aiming to address the shortcomings mentioned earlier. This transformation required the mobilization of political will, a shift in perceptions through knowledge and capacity building, and building trust. Established in 1998 under a World Bank project, the paper-based collateral registry was outdated and provided limited service, viewed more as procedural than value-driven.

The project assisted in the adoption of amendments to the Pledge Law and Civil Code that allowed the collateral registry to transition into a modern digital platform based on online notices.

Phase 3: Financial Literacy
The final phase of project implementation focused on the promotion of usage of credit infrastructure by all relevant financial market players. This included the implementation of a financial literacy program, conducted in partnership with 13 financial institutions. This initiative successfully educated 469,500 adults in essential financial literacy concepts and money management skills, aiming to promote improved credit behavior and loan repayment discipline.

469,500

adults educated in essential financial literacy concepts and money management skills.

Results

By project close in 2019, the project had facilitated $4.01 billion in financing for 2.1 million individuals and MSMEs through the modernized credit information sharing system and allowed 74,400 MSMEs to access $237 million in finance through the establishment of the centralized collateral registry (2020). By 2023, the project had facilitated over $5.3 billion in financing for more than 4.6 million individuals and MSMEs in total.

The existing credit bureau was transformed from a not-for-profit organization to a commercial business in 2012. Since then, it has driven national progress, offering high-quality credit histories, advanced online scoring models, and an agri-finance scoring tool. In 2018, a second private credit bureau was opened. As of 2023, the credit bureaus issue a variety of traditional products as well as value added services for better risk management and new product development. They issue special monitoring reports that automatically notify lenders of any changes in a borrower's credit history, for example if a new customer request has been made by another financial institution, as well as lists of active borrowers with multiple loans from multiple financial institutions. They also offer benchmarking reports for financial institutions in comparison with the market and analytical reports on sector trends, including for example the number of active loans in retail and for MSMEs. To potentially revitalize the agri-lending sector through enhanced risk management practices, IFC developed and introduced the innovative Cash-flow Linked Agriculture Risk Assessment (CLARA) product line to be integrated into the credit reporting system.

Consequently, the project has helped to strengthen the risk management capabilities of financial institutions by introducing new tools for credit underwriting and risk management. By project conclusion in December 2019, 14 financial institutions had implemented recommended changes, surpassing a target of eight, and 35 financial institutions had adopted recommended standards and policies, exceeding a target of 13.

$5.3B

in financing for more than 4.6 million individuals and MSMEs facilitated by 2023.

These measures helped to stabilize the ratio of non-performing loans (NPLs), reduce over-indebtedness, and introduce new lending products for retail and MSMEs, utilizing credit histories and innovative scoring tools.

The project facilitated a $1.5 million investment in the commercialized credit bureau by an international credit bureau and local banks. After project completion, additional investments exceeding $2 million were made into both credit bureaus by foreign and local investors. The project also facilitated an $8 million IFC investment in the Kyrgyz Highland Fund along with other investors, the first institutional private equity fund in the country. The Fund leverages the conducive financial sector environment fostered by improved financial infrastructure to provide growth capital to local MSMEs in services, agricultural processing, health, education, telecommunications, media, and technology. Advanced credit reporting products, introduced following the transformation of the existing credit bureau, are now utilized to evaluate all loans disbursed by the Kyrgyz Highland Fund.

Initiated in response to the 2008 global financial crisis and active during the 2015 financial instability in Kyrgyz Republic, the project's ongoing technical assistance likely mitigated the impact on banks and non-bank financial institutions (NBFIs) during the latter crisis. Project support, together with other focused measures by the authorities, contributed to gradual improvements in financial sector stability following the crisis.

The ACAFI project was succeeded by two subsequent IFC projects to develop movable asset-based lending and to enhance value chain financing in Kyrgyz Republic.

Impact

An evaluation and client satisfaction survey from 2022 highlights the impact of the project in the financial sector. Respondents noted that nearly all major recommendations from IFC were effectively supported and implemented. Additionally, nearly all client representatives who worked with the project expressed satisfaction or high satisfaction with the quality of advisory services provided by IFC staff and consultants. The original credit bureau, CIB Ishenim, credited the project with the advance of credit reporting infrastructure in the country: "Thanks to the efficient collaboration between ACAFI, the Association, the NBKR, the Union of Banks, and the entire financial sector, coupled with the high caliber of expertise provided by IFC, we were able to develop the Law on Credit Information Exchange, subsequently adopted by the Parliament of the Kyrgyz Republic."

Results in numbers

$5.22B

financing facilitated by credit bureaus by 2023

4.5M

number of individuals and MSMEs that received loans supported by credit histories by 2023

$305M

financing facilitated by the collateral registry by 2023

96K

number of MSMEs that had gained access to finance through the collateral registry by 2023

$2.1M

investment in credit bureaus facilitated by the project

$8M

IFC investment in Kyrgyz Highland Fund made possible by the project

Next steps

The first phase of the Global Partnership for Financial Infrastructure ran from 2015 to 2021. It is followed by a second phase from 2022 to 2027, with IFC and SECO as founding partners. The second phase of the program focuses on strengthening credit information systems, secured transaction reforms, movable asset-based lending, insolvency and debt resolution, and innovative product development based on big data analytics. It aims to expand responsible access to finance and facilitate financial inclusion for individuals and MSMEs underserved by the market.