ASIAN INFRASTRUCTURE INVESTMENT BANK

PD000423-KGZ
August 13, 2020

Project Document
of the Asian Infrastructure Investment Bank
Sovereign-backed Financing

Kyrgyz Republic

Emergency Support for Private and Financial Sector Project
(under the Covid-19 Crisis Recovery Facility)

Currency Equivalents
(As of August 4, 2020)

Currency Unit – Som (KGS)
KGS1.00 = USD 0.0129
USD1.00 = KGS 77.3505

Borrower's Fiscal year
January 1 - December 31

Abbreviations

AIIB	Asian Infrastructure Investment Bank
CLA	Co-Lenders' Agreement
COVID-19	Coronavirus Disease 2019
CRF	COVID-19 Crisis Recovery Facility
ES	Environmental and Social
ESF	World Bank's Environmental and Social Framework
ESP	AIIB's Environmental and Social Policy
ESS	WB's Environmental and Social Standards
FI	Financial Intermediary
GDP	Gross Domestic Product
GF	Open Joint Stock Company Guarantee Fund
GRM	Grievance Redress Mechanism
GRS	Grievance Redress Service
IDA	International Development Association
IUFR	Interim Unaudited Financial Report
MSMEs	Micro, Small and Medium Enterprises
MoF	Ministry of Finance
M&E	Monitoring and Evaluation
NBKR	National Bank of the Kyrgyz Republic
NCB	Non-Concessional Borrowing
PFI	Participating Financial Intermediaries
PIU	Project Implementation Unit
PPM	Project-affected People's Mechanism
PRSF	Portfolio Risk Sharing Facility
RFA	Reimbursable Financial Assistance
SDA	Selected Disbursement Administrator
SFW	Special Fund Window
WB	World Bank

Contents

1. Summary Sheet
The Kyrgyz Republic
Emergency Support for Private and Financial Sector Project

Project No.	PD000423
Borrower	Kyrgyz Republic
Project Implementation Entity	Project Implementation Unit at the Ministry of Finance (Kyrgyz Republic)
Sector Subsector	Finance / Intermediary financing
Project Objective	The Project objective is to support micro, small and medium enterprises (MSMEs) in response to and during the recovery from the COVID-19 crisis.
Project Description	The project will be jointly co-financed with the World Bank (WB), and is comprised of Reimbursable Financial Assistance (RFA) to MSMEs and a Portfolio Risk Sharing Facility (PRSF), offering a fee-based partial portfolio credit guarantee to share part of the credit risk in MSME credits from eligible Participating Financial Intermediaries (PFIs).
Implementation Period	Start Date: August 2020 End Date: July 2024
Expected Loan Closing Date	July 2024
Cost and Financing Plan	Project cost: USD100 million Financing Plan: AIIB USD 50 million World Bank/IDA USD 50 million SFW Interest buy-down of USD 8.87 million[1]
Size and Terms of AIIB Loan	USD 50 million. Final maturity of 32 years, and average maturity of 18.55 years, including a grace period of 5 years. AIIB's standard interest rate for sovereign-backed loans minus 100 bps through the Special Fund Window.
Cofinancing (Size and Terms)	World Bank (lead) IDA grant: USD 25 million IDA credit: USD 25 million
Environmental and Social Category	World Bank Category: Moderate Risk (equivalent to Category FI if AIIB's ESP was applicable).
Risk (Low/Medium/High)	Medium
Conditions of Effectiveness	a) the WB financing agreement has been executed by the WB and the Kyrgyz Republic; b) the Co-Lenders' Agreement between AIIB and the WB has been executed; and

[1] The interest buy-down may go up to USD 9.4 million if the loan is disbursed in one tranche at loan signing.

	c) The Ministry of Finance (MoF) has adopted the Project Operational Manual (POM) in form and substance satisfactory to the WB and AIIB.
Key Covenants/Conditions for Disbursement	Conditions for Disbursement: a) No withdrawal shall be made under Category (1) – RFA - until and unless the Recipient, through MoF, has adopted the RFA Procedural Manual in a manner satisfactory to the AIIB and WB. b) No withdrawal shall be made under Category (2) – PRSF: (i) for the Initial Tranche, unless and until the Recipient has (A) established the PRSF and the PRSF Account in a manner satisfactory to the WB and AIIB (Banks); (B) adopted, through MoF, the PRSF Procedural Manual satisfactory to the Banks; and (C) concluded the Guarantee Fund (GF) Agent Agreement satisfactory to the Banks; and (ii) for each subsequent tranche, unless and until the Recipient has furnished evidence satisfactory to the Banks of issuance Portfolio Partial Credit Guarantees covering 70 percent of the capital under the preceding tranche.
Retroactive Financing (Loan % and dates)	Retroactive financing up to 10% or USD 5 million may be required for eligible expenditures under the Project made on or after AIIB loan negotiation date, July 16, 2020.
Policy Assurance	The Vice President, Policy and Strategy, confirms an overall assurance that the Bank is in compliance with the policies applicable to the project.

President	Jin Liqun
Vice President	Konstantin Limitovskiy, Investment Operations, Region 2
Director General	Supee Teravaninthorn, Investment Operations Technical Department, Region 2
Manager	Gregory Liu, Technical Department, Region 2
Project Team Leader	Natalia Carla Sanz, Senior Investment Operations Specialist
Team Members	Amy Fang Lim Chua, Environmental Specialist Anne Ong Lopez, Young Professional Christopher Damandl, Senior Legal Consultant Jia Cao, Client Relations Associate Jurminla Jurminla, Senior Procurement Specialist Martin Naegele, Senior Client Relations Officer Susrutha Goonasekera, Senior Social Development Specialist Yige Zhang, Project Assistant Yogesh Malla, Financial Management Specialist

2. Project Description

A. Project fit under the COVID-19 Crisis Recovery Facility.

1. **The COVID-19 Pandemic:** Since its initial outbreak on March 31, 2020, the COVID-19 pandemic has spread rapidly in the Kyrgyz Republic, reaching 192 daily confirmed cases by mid-June. As of July 1, 2020, the total confirmed cases reached 5,735, representing 878 cases per million people.[2] Although the scope and duration of the COVID-19 pandemic are difficult to model, the economic impact on Kyrgyz, a small open economy reliant on services, remittances and natural resources, is expected to be significant. The necessary measures put in place by the country to mitigate the spread of the pandemic, including the closure of borders for non-resident entry and the suspension of non-essential businesses, have disrupted labor markets, international value chains, and the trade of intermediate inputs to production.

2. The sharp contraction in remittance flows and the demand shock are also impacting the service sector, with the likely loss of the 2020 tourism season. While the strict quarantine is currently being relaxed, uncertainty remains as to whether further measures will be needed to respond to new waves of the pandemic. According to the most recent estimates, GDP is expected to contract by 4 percent in 2020, and the poverty rate is projected to increase to 19.1 percent compared with 15.3 percent in 2019.[3]

3. **The liquidity constraints caused by COVID-19.** The COVID-19 crisis is making it increasingly difficult for micro, small, and medium enterprises (MSMEs) to meet operational expenses such as payroll, supplies, rent, and utilities. The longer the crisis extends, the greater the risk that otherwise healthy businesses may fail. Even when new firms enter the market, it may take years to rebuild value chains, re-train the workforce, find new suppliers and markets, and attract new investment. As of June 15, the COVID-19 crisis has affected 50 percent of the total credit portfolio (around KGS 70 billion/USD 875 million in restructured loans).[4] Without liquidity support to MSMEs and the financial sector, some of these restructured loans are expected to become non-performing.

4. Financial Intermediaries (FIs) can be expected to face reduced profitability, weaker asset quality, and lower deposit mobilization, negatively affecting liquidity and solvency of the FIs as well as their risk-appetite to extend further credit. This may deprive firms of critical financing to cover operational expenses and survive the COVID-19 crisis. This vicious circle is expected to amplify the COVID-19 shock, creating a negative feedback loop between the financial and real sectors.

5. **Country priorities.** The Government of the Kyrgyz Republic approved an Anti-Crisis Plan on May 6, 2020, including measures to support private and financial sectors, such as: (i) establishment of the Government Anti-Crisis Program to finance subsidized lending programs for businesses and re-capitalization of the Open Joint Stock Company Guarantee Fund (GF); (ii) fiscal measures to support businesses (such as tax and social payments relief); and (iii) recommendations to the National Bank of the Kyrgyz Republic (NBKR) on softening regulatory requirements to banks, further restructuring of loans and provision of loans

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[2] http://www.med.kg/en/informatsii-2.html
[3] World Bank projection
[4] Source: National Bank of Kyrgyz Republic (as reported by Bishkek - 24.kg news agency on June 16, 2020)

through auctions for banks and micro finance institutions for on-lending to businesses.

6. On the guarantees side, the Government established the GF in 2016 to help improve access to finance by sharing risk with and reducing collateral requirements from financial institutions[5]. The GF has played an increasingly important role in supporting MSMEs access to finance, providing individual-loan guarantees, of which demand has increased four-fold in two years, reaching USD 13.2 million in 2019[6]. However, the individual-loan guarantee product currently offered by the GF prevents it from being scaled up quickly to respond to the COVID-19 crisis, since it requires that the GF conduct independent credit analysis for each individual loan guarantee application.

7. The Project will build upon the Government's Anti-Crisis Plan complementing the fiscal measures with financial assistance to enterprises for them to continue meeting their operational expenses, and enhancing the impact of the planned liquidity support for banks through a Portfolio Risk Sharing Facility (PRSF), to be managed by the GF.

8. **Project's alignment with AIIB's COVID-19 Crisis Recovery Facility.** The proposed Project entails addressing the MSMEs liquidity needs via reimbursable financial assistance[7], and a portfolio risk sharing facility to eligible financial institutions. As such, the Project is aligned with the COVID-19 Crisis Recovery Facility (the Facility) objective to provide "financing to address liquidity constraints for clients in infrastructure and other productive sectors".

9. **Co-financing.** The Project will be jointly co-financed by the World Bank (WB) and AIIB, and will follow the WB's environmental and social, financial management and procurement arrangements. Following the institutional co-financing framework between the two Banks, a Project Co-Lenders' Agreement (CLA) is being developed between WB and AIIB.

10. **Non-concessional borrowing.** The Kyrgyz Republic was under Non-Concessional Borrowing (NCB) limits with the now expired IDA NCB policy[8]. The parameters of the new Sustainable Development Financing Policy (SDFP) are currently under negotiation, but given the fact that the AIIB loan will include the SFW interest buydown, the loan is deemed concessional, with a grant element above 35%, and henceforth will not be subject to this new policy, whatever the new NCB limits, if any, will be for the Kyrgyz Republic. The grant element will be recalculated once the loan terms are determined.

B. Project Objective and Expected Results.

11. **Project Objective.** The Project objective is to support MSMEs in response to and during the recovery from the COVID-19 crisis.

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[5] According to the 2019 World Bank Enterprise Survey, more than 90 percent of firms that received loans had to provide collateral averaging 244 percent of the loan value. This is significantly higher than the 178 percent for the region.

[6] By World Bank's estimation, the GF currently offers four types of individual-loan guarantee products tailored to the financing needs for MSMEs (for example, differing based on loan size and maturity). In 2019, the GF issued 946 guarantees (worth a total of US$13.2 million), compared with 234 guarantees (worth a total of US$3.4 million) in 2017.

[7] AIIB proceeds will not finance reimbursable financial assistance to micro-enterprises.

[8] The NCBP expired on June 30, 2020.

12. **Expected Results.** The Results Monitoring Framework (included in Annex 1) follows the WB Results Framework. The Project Objective Indicators include:

    (a) Share of MSMEs benefiting from the Reimbursable Financial Assistance (RFA) (Component 1) that survive the COVID-19 crisis;

    (b) Share of MSMEs benefiting from the Portfolio Risk Sharing Facility (PRSF) (Component 2) that survive the COVID-19 crisis.

13. All the indicators will be periodically measured by the WB and AIIB during implementation to ensure the Project is progressing in accordance with the implementation plan.

14. **Expected Beneficiaries.** The primary beneficiaries of the Project will be the MSMEs, which will benefit directly from the financial assistance and ultimately from the portfolio guarantees. It is estimated that more than 45,000 SMEs will benefit from the RFA to meet short term operational expenditures, and 5,000 MSMEs are expected to also benefit from receiving PRSF-supported loans to cover operational expenses and post-crisis investment needs, with special focus on female-headed MSMEs. The financial institutions supporting the MSMEs will also benefit from lower credit risk and capacity building associated with the PRSF.

15. Indirect beneficiaries will include the employees of the benefiting SMEs whose payroll will be paid from the proceeds of the RFA and the PRSF-supported loans. The RFA is expected to contribute to the retention of more than 65,000 jobs. Finally, the RFA and PRSF will prevent business closures, preserve and generate jobs, and enhance productivity and exports, which would ultimately benefit the Kyrgyz economy.

C. Description and Components

16. **Overview.** The Project seeks to inject liquidity into the Kyrgyz private sector, targeting at the MSMEs via two instruments: (i) reimbursable financial assistance, and (ii) portfolio guarantees to the Participating Financial Intermediaries (PFI), a risk sharing facility to unlock the provision of credit to eligible MSMEs.

17. **Component 1. Reimbursable Financial Assistance (RFA) for MSMEs (USD72 million).** This component is aimed at helping businesses survive the economic slowdown and retain employees by supporting the MSMEs' short-term liquidity needs for operational expenses. AIIB proceeds will finance Sub-component 1.2, RFA for SMEs, given that financing RFA to micro enterprises would not be consistent with the sectors the COVID-19 Crisis Recovery Facility aims to support, namely infrastructure and other selected productive sectors. The RFA will be provided to eligible SMEs during a period of 12-18 months. Some financial institutions will serve as the government's agents, Selected Disbursement Administrators (SDAs), to disburse the proceeds of RFA. The Project Implementation Unit (PIU) will undertake the selection, monitoring and coordination with the SDAs and will prepare the RFA Procedural Manual for this purpose.

18. The SDAs will be responsible for verifying the beneficiary eligibility and confirming the use of funds. The RFA will be deposited to the financial account

of the beneficiary.[9] While the component is expected to cover all eligible beneficiaries, the RFA will be awarded on a first-come first-serve basis in the case of higher than expected uptake (until all funds have been disbursed). See Annex 2 for more details.

19. Component 1 is comprised of two sub-components:

a. *Sub-component 1.1: RFA for micro entrepreneurs (USD 30 million, fully financed by the WB)* will provide RFA to eligible micro entrepreneurs.

b. *Sub-component 1.2: RFA for SMEs (USD 42 million, co-financed by AIIB and WB).* This sub-component will provide RFA to eligible SMEs (from a total pool of approximately 46,500 businesses[10]). The RFA will be proportional to the size of businesses as measured by the number of formal employees, and will be subject to: (i) the verification of the business viability prior to COVID-19 (as measured by *inter alia*, at least one year of continuous non-loss making operation, no outstanding arrears on tax or social repayment obligations, and no negative credit reports[11]); (ii) the use of the funds to cover a pre-determined set of eligible operating expenses including payroll, suppliers, rent, and utilities to be covered in a "cascade approach"[12]; and (iii) the use of electronic payments for the settlement of expenses.[13]

20. **Component 2. Portfolio Risk Sharing Facility (PRSF) (USD 25.5 million).** This component will finance the establishment and funding of the PRSF, seeking to reduce the risk of financial sector deleveraging from MSMEs' lending during the crisis, and to ensure credit provision to MSMEs during the recovery. This will be achieved through the creation of a facility to be managed by the GF, that will offer a fee-based partial credit portfolio guarantee to share part of the credit risk in eligible MSME credits from eligible Participating Financial Intermediaries (PFIs).

21. PFI eligibility will be based on criteria such as meeting key prudential norms and demonstrating sound credit procedures and information systems, and will be detailed in the PRSF Procedural Manual to be prepared by the GF. The facility will offer guarantees on a portfolio basis, and all eligible MSME credits from the PFIs will be included automatically in the facility. The portfolio approach will complement the existing individual-loan guarantee products currently offered by the GF.[14]

a. *Sub-component 2.1: Financing for the PRSF (USD 24 million, co-financed by AIIB and WB).* The PRSF will be financed under three windows: (i) Window 1: short-term loans and overdrafts to MSMEs; (ii) Window 2: restructured

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[9] Enterprise Survey data shows that most small and medium legal enterprises have an existing financial account. However, the share of individual entrepreneurs will be much lower. Eligible firms without a financial account will be required to open one.

[10] The beneficiary pool includes 30,000 individual entrepreneurs registered with a certificate from the State Tax Service, 1,250 individual entrepreneurs working through a special tax regime known as Tax Contract, 14,520 small legal entities, and 769 medium legal entities.

[11] As of the most recent full FY tax return -- either December 31, 2019 or December 31, 2018, supported by the most recent 2019 quarterly filing.

[12] Each category must be fully paid current before a firm can apply the financial assistance to a subsequent category.

[13] A specific exclusion might apply for the payment of salaries to employees.

[14] The individual-loan guarantees focus on (i) loans to large firms; (ii) loans above the guarantee threshold set in the PRSF, and (iii) loans from financial institutions not participating in the PRSF.

MSME credits that were in good standing prior to the COVID-19 crisis; and (iii) Window 3: new MSME long-term loans. Windows 1 and 2 aim to alleviate the risk of deleveraging by the financial sector during the crisis[15]; Window 3 is primarily aimed at supporting the post-COVID-19 crisis recovery.[16]

b. *Sub-component 2.2: Technical Assistance (USD 1.5 million, fully financed by the WB)*. Given the portfolio guarantee is a new concept for the country, this component will also finance technical assistance for capacity building of the GF, PFIs, National Bank of the Kyrgyz Republic (NBKR) and other stakeholders.

22. **Component 3. Project implementation, coordination and management (USD 2.5 million).** AIIB proceeds in this component will co-finance the commission to the SDAs for the distribution of the RFA to beneficiaries, including the screening of RFA beneficiaries with a focus on gender and social coverage. This component will also include, among others, PIU and GF staff, experts and operational costs related to project implementation including project audits, to be fully covered by the WB financing.

D. Cost and Financing Plan

23. The total project cost is USD 100 million, to be jointly co-financed by AIIB and the WB. The WB will provide USD 50 million, comprised of an IDA grant of USD 25 million, and an IDA credit of USD 25 million. AIIB financing will include a loan for USD 50 million and the interest buydown through the Special Fund Window (SFW).

24. **Special Fund Window.** The Government of the Kyrgyz Republic requested the use of the SFW to reduce the interest to be paid by the country. Considering a 32-year final maturity and 5 years of grace period, the indicative buy-down amount is USD 8.87 million based on current disbursement schedule and financial assumptions[17], and could go up to USD 9.4 million if disbursed in one tranche at loan signing, which is within the USD 10 million country limit. The buy-down amount will be recalculated once the loan terms are determined.

Table 1. Project Cost and Financing Plan

Item	Project Cost (USD m)	Financing (USD m and %)	
		AIIB	WB
Component 1: Reimbursable Financial Assistance for MSMEs	**71.7**	**36.7**	**35**
Subcomponent 1.1: RFA for Microentrepreneurs	30	0	30
Subcomponent 1.2: RFA for SMEs	41.7 (100%)	36.7 (88%)	5 (12%)

[15] Windows 1 and 2 are intended for crisis support. Typically, risk sharing facilities do not cover restructured credits during normal (non-crisis) times.
[16] A sunset clause will kick in at the end of the crisis, closing emergency support and potentially migrating windows toward sustainable operation. For example, Window 3 could include both short-term and long-term loans after emergency support under Window 1 is closed. More details would be included in the PRSF Procedural Manual.
[17] Under the current assumptions the loan deeps a Grant Element over 35%.

Component 2: Portfolio Risk Sharing Facility	**25.2**	**12.2**	**13**
Subcomponent 2.1: Financing for PRSF	23.7 (100%)	12.2 (51%)	11.5 (49%)
Subcomponent 2.2: Technical Assistance	1.5	0	1.5
Component 3: Project Implementation, Coordination and Management	**2.5 (100%)**	**0.5 (20%)**	**2 (80%)**
Other costs	**0.6**	**0.6**	**-**
Front-end fee	0.125	0.125	-
Interest	0.475	0.475	-
Loan Amount	**100 (100%)**	**50 (50%)**	**50 (50%)**
Special Fund Window Grant Amount	8.87[18]	8.87	-
Grand Total	**108.87**	**58.87**	**50**

E. Implementation Arrangements

25. **Implementation period.** The Project implementation period is expected to be four years, from August 2020 until July 2024.

26. **Implementation Management.** An existing PIU within the Ministry of Finance (MoF) will be responsible for the overall Project fiduciary, safeguards, monitoring and evaluation (M&E) activities. This PIU has been implementing World Bank-funded projects in the Kyrgyz Republic since 2002 with successful results, following the WB policies and procedures. To avoid duplicating roles in different agencies, the MoF PIU will manage the implementation of the RFA under Component 1, while the GF will manage the PRSF under Component 2.

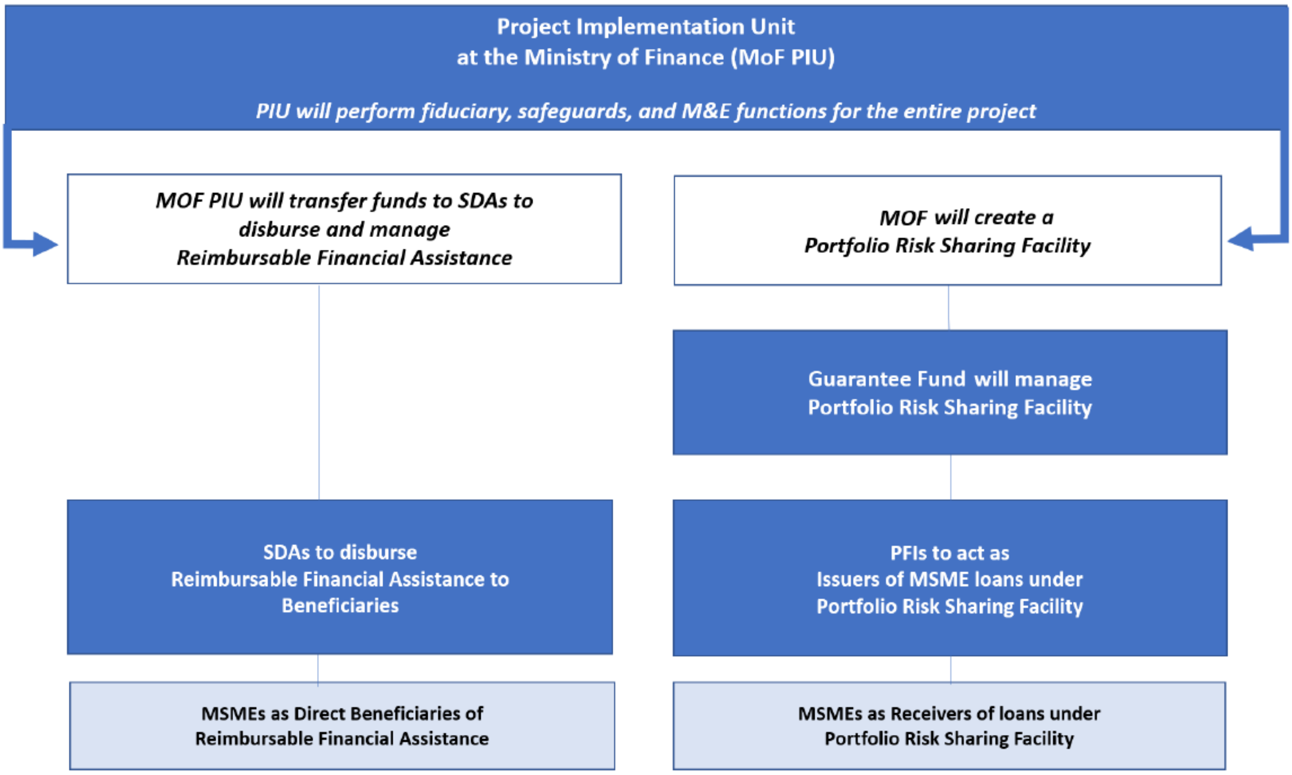
a. *RFA management (Component 1).* The MoF PIU will: (i) prepare and agree with the MoF and the Banks the selection criteria for SDAs who will act as disbursement agents for the RFA; (ii) prepare the RFA Procedural Manual, detailing the implementation arrangements, terms and conditions; and (iii) carry out the outreach campaign for the RFA in collaboration with the SDAs. The MoF will sign the agreements with the SDAs, which will then receive funds from the MoF PIU to disburse financial assistance to MSMEs. The SDAs will have a variable ceiling, based on a six-month forecast to cover project implementation needs. The MoF will ensure reimbursement of the RFA through the State Agency on Budget Loans Management (SABLM) under the MoF.

b. *PRSF management (Component 2).* The GF is the only guarantee fund operating at a national scale and will manage the PRSF on behalf of the MoF, which will be ultimately responsible for the performance of the Facility. The GF has experience working with the WB[19], and will be in charge of[20]: (i) selecting eligible PFIs and facilitating the signing of agreements with them; (ii) preparing the PRSF Procedural Manual, detailing the implementation arrangements, terms and conditions; (iii) conducting information sessions to

[18] Up to USD 9.4 million.
[19] Integrated Dairy Productivity Improvement in the Kyrgyz Republic project, P155412.
[20] The WB has conducted a due diligence of the GF to assess its eligibility for this Project in accordance with the WB OP10.

introduce PRSF to financial institutions; and (iv) managing the day to day operation of the PRSF.

Figure 1. Project Implementation Arrangements



27. The Government of the Kyrgyz Republic will establish a national-level steering committee to oversee the Project and serve as the highest-level consultative and decision-making body, responsible for strategic guidance, coordination, and implementation support.

28. **Monitoring and Evaluation.** The MoF PIU will oversee data collection and report on M&E indicators. The PIU has M&E capacity, as demonstrated by its previous implementation of WB-financed projects. The PIU will maintain an RFA recipient database. The GF will provide the PIU with data related to the PRSF, following the PIU's request. The PIU, with support from the GF, will prepare quarterly reports to assess progress on project activities and the need for any adjustments based on results framework data discussed during the Banks' implementation support missions. The steering committee will guide the high-level decision-making pertaining to the project, including the midterm review of the project. A dedicated M&E specialist within the PIU will be responsible for data collection and reporting.

29. **AIIB's Implementation Support.** The WB, as the lead co-financier, will take the lead on supervising the program, in accordance with WB's applicable policies and procedures, and a Project CLA, to be signed between AIIB and the WB following the existing Co-financing Framework Agreement between the Banks. WB and AIIB will jointly supervise the technical, fiduciary and environmental and social aspects during the Project implementation period to assure policy compliance and to support the capacity building in the MoF PIU and the GF for managing the RFA and PRSF, respectively.

30. **Procurement.** The Project aims to support MSMEs in response to and during the recovery from the COVID-19 crisis. Given that the bulk of the loan amount will be utilized to inject liquidity into the Kyrgyz private sector targeting the MSMEs, it is anticipated that only small portion of the loan amount will involve procurement. All procurement of contracts will be conducted through the procedures as specified in the World Bank's Procurement Regulations and will be subject to World Bank's Anti-Corruption Guidelines. The World Bank's Procurement Regulations and Anti-corruption guidelines are materially consistent with AIIB's Procurement Instructions to Recipient and Prohibited Practices and therefore, deemed fit-for-purpose.

31. **Financial Management.** MoF will be responsible for overall project financial management. The existing MoF PIU shall act as the PIU for this project. The project planning, budgeting, funds flow, accounting, reporting, internal controls, and audit arrangements shall be aligned with the Government's system to the extent possible. The PIU shall prepare project annual work plan and budget as per procurement plan and financing agreements.

32. The PIU has adequate and qualified finance/accounts staff for maintaining acceptable project financial management arrangements. Considering the additional workload, the PIU will recruit a Disbursement Specialist under terms and conditions satisfactory to AIIB and the WB. MoF PIU shall procure acceptable automated accounting software for the accounting and reporting of project specific financial activities. A Project Operational Manual (POM) shall be prepared and adopted by the PIU, detailing the project financial management and disbursement arrangements including internal control framework acceptable to AIIB and the WB. The PIU will administer the RFA component through eligible SDAs and the details of its operating guidelines will be stated in the RFA Procedural Manual. The MoF will establish the PRSF based on the PRSF agreement between MoF and GF in the manner acceptable to AIIB and the WB. GF will manage PRSF component through eligible PFIs and the details of its operating guidelines will be stated in the PRSF Procedural Manual.

33. The PIU shall prepare project accounts in accordance with acceptable accounting standards. It shall prepare and submit Interim Unaudited Financial Reports (IUFRs) to the Banks within 45 days of the end of each quarter. The annual audited project financial statement shall be submitted to the Banks within six months of the end of each fiscal year. The independent private auditor shall conduct the annual project audit in accordance with applicable standards and terms of reference acceptable to the Banks. The PIU will publicly disclose the audit reports on its website within one month of the receipt from the auditors and acceptance by the Banks.

34. **Disbursements.** The WB's disbursement policies and procedures shall be used for the project disbursement following the co-financing framework agreement. The withdrawal applications shall be submitted to the WB for review. The payment instructions shall be communicated by the WB to AIIB, based on respective ratio between AIIB and the WB financing. The WB will (a) review each withdrawal application furnished by MoF PIU to verify that the amount requested is eligible for financing; and (b) notify AIIB that the withdrawal application is in proper order, and that it has determined that the amount requested is eligible for AIIB financing under AIIB Loan Agreement.

35. The adoption of the Procedural Manuals will be disbursement conditions. The disbursement of Loan proceeds will be made using the reimbursement, direct payment, special commitments and advance methods. The detailed

disbursement arrangements shall be set out in the WB's Disbursement and Financial Information Letter (DFIL), which shall detail the authorized signatories, methods of disbursement, Designated Account arrangements, process of submitting claims and other terms and conditions of disbursements related to the project for both WB and AIIB loans.

3. Project Assessment

A. Technical

36. **Project Design.** The Project will provide emergency relief and recovery support to the private sector. The RFA will provide funds to cover SMEs' operational expenses, with the SMEs' employees a priority, while the PRSF will incentivize the risk-averse banks to lend to eligible MSMEs. The project will also build the GF and the PFIs institutional capacity in implementing the PRSF, which would improve firms' access to finance in the medium to long term.

37. **Eligibility criteria for SDAs, PFIs and MSMEs.** For Component 1, SDAs and SMEs eligibility criteria will be detailed in the RFA Procedural Manual. The government will propose a set of pre-selected SDAs that will be screened against this eligibility criteria. Regarding Component 2, PFIs and credit portfolio eligibility will be detailed in the PRSF Procedural Manual. PFIs will be chosen through calls for expression of interest, and all PFIs and the credit portfolios will have to meet the eligibility criteria.

38. **Operational sustainability.** The project will promote sustainability by working through existing institutions, while building their capacity. Component 1 will be implemented through SDAs to ensure comprehensive geographic coverage and to minimize the cost and time needed to deliver the instrument. Financial assistance under the component will be based on performance to avoid financing non-viable firms and distorting the private sector. Component 2 will include capacity building to ensure that the new PRSF instrument can continue to serve after project completion.

B. Fiduciary and Governance

39. **Procurement.** As mentioned above, an existing PIU within the MoF will implement this project. The WB team conducted a procurement capacity and risk assessment and accordingly mitigation measures are proposed in the WB Project Procurement Strategy for Development (PPSD), equivalent to AIIB Project Delivery Strategy. The PPSD also outlines procurement arrangements for the Project. The WB has shared the draft PPSD along with the procurement plan and AIIB concurs with the procurement arrangements reflected in PPSD. In addition, for ease of project operations, the PIU will prepare a POM.

40. **Financial Management.** The MoF PIU has extensive experience of over 18 years implementing WB-financed projects. The WB carried out a Financial Management (FM) assessment of the PIU and concluded it has reasonable accounting systems and adequate capacity to support the FM functions required for the project, including planning, budgeting, funds flow, accounting, internal controls, financial reporting, and external auditing. MoF PIU's FM staff have adequate experience in implementing WB-financed projects. The IUFRs were generally received on time and found to be acceptable under WB-financed projects implemented by the PIU.

41. There are no pending audits under WB-financed projects implemented by the MoF PIU. It was noted that the auditors, generally, issued unmodified (clean) opinions on the financial statements with no major issues in the management letters.

42. The financial management capacity of the GF has also been assessed and its arrangements were found to be satisfactory with adequate FM systems in place for its role in project implementation. The GF is subject to annual audit of its financial statements prepared in compliance with the International Financial Reporting Standards (IFRSs) according to the legislation of the Kyrgyz Republic with respect to financial institutions.

43. Annual project financial audits will be required. The external audits will be conducted (i) by independent private auditors on terms of reference (TOR) acceptable to AIIB and the WB; and, (ii) according to the International Standards on Auditing issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The cost of the project audits will be financed from the proceeds of the project under Component 3.

44. The overall project financial management risk is considered as High due to (i) emergency nature of the project; (ii) the innovative project instruments including RFA and PRSF (partial guarantee activities); (iii) funds flow mechanism involving several channels before reaching the final beneficiaries; and (iv) risks and uncertainty due to impact of the COVID-19 pandemic. Corruption is perceived as a risk during project implementation. Adequate mitigation measures have been established and these measures will be closely monitored to ensure that the residual project risk remains acceptable. These measures include: (i) a formal internal control framework described in the Project Operational and Procedural Manuals; (ii) flow of funds mechanism via acceptable commercial bank(s); (iii) audit of the project financial statements by independent auditors and on terms of reference acceptable to AIIB and the WB; and (iv) regular FM implementation support and supervision.

45. **Retroactive Financing.** The retroactive financing of up to USD 5 million equivalent (i.e. up to 10 percent) of the AIIB loan will be allowed for reimbursement of eligible expenditures for payments made by the project on or after AIIB loan negotiation date until the signature date of AIIB Loan Agreement. It shall be allowed only if the expenditures are eligible, including that they are incurred/ items are procured in accordance with the applicable WB's Procurement Regulations, as well as other WB and AIIB conditions or requirements.

46. **Governance and Anti-corruption.** AIIB is committed to preventing fraud and corruption in the projects it finances. For this project, World Bank's Anti-corruption guidelines and its definition of prohibited practices which are materially consistent with those in AIIB's Policy on Prohibited Practices (2016), shall apply. However, the Bank reserves the right to investigate, directly or indirectly through its agents, any alleged corrupt, fraudulent, collusive, coercive or obstructive practices, and misuse of resources and theft or coercive practices relating to the program and to take necessary measures to prevent and redress any issues in a timely manner, as appropriate.

47. **Institutional Capacity.** The Project includes the necessary implementation arrangements, technical assistance, and institutional capacity building activities to attain and sustain the Project objectives.

C. Environmental and Social

48. **Applicable Policy, Categorization, Instruments, Risks and Management.** The loan will be co-financed with the WB as lead co-financier, and the Project's environmental and social (ES) risks and impacts have been assessed in accordance with the WB's Environmental and Social Framework (ESF). To ensure a harmonized approach to addressing the ES risks and impacts of the project, and as permitted under AIIB's Environmental and Social Policy (ESP), the WB ESF will apply to the project in lieu of AIIB's ESP. AIIB has reviewed the WB ESF and is satisfied that: (a) it is consistent with AIIB's Articles of Agreement and materially consistent with the provisions of AIIB's ESP and the relevant ES Standards; and (b) the monitoring procedures that are in place are appropriate for the project. The WB has categorized the ES risks of this program as "Moderate", which is equivalent to Category FI if AIIB's ESP were applicable.

49. **Environmental and Social Aspects**. Environmental risks are expected to be site-specific, temporary and readily addressed through standard mitigation measures and compliance with national laws.

50. Under Component 1, the RFA will be disbursed to eligible MSMEs. Funds under this component will be used exclusively for operating expenses, including payroll, rent, utilities, and goods and services. Expenditures for works, including minor rehabilitation or land acquisition, will not be eligible for financing. SDAs will disburse the RFA acting as agents on behalf of the government. The PIU will undertake the selection, monitoring and coordination with the SDAs. The SDAs will be responsible for verifying the beneficiary eligibility and confirming that the funds will only be used to cover for eligible expenses.

51. Under Component 2, the PRSF would be used by PFIs to partially guarantee short-term credits and overdrafts, restructured MSMS loans that were in good standing prior to the COVID-19 crisis, and new MSME loans. The PIU will require PFIs to develop and implement an Environmental and Social Management System (ESMS) acceptable to the PIU and the Banks, to classify and manage the environmental and social risks of their financing activities. Only those MSMEs whose business activities are judged to be of moderate or low ES risks will be eligible for project support under Component 2. The PIU will also maintain a negative list of activities that are ineligible for support under this component, including major civil works or other activities that would increase the overall environmental or social risk of the project.

52. The key social issues relate to: (i) exclusion/ inclusion – providing an opportunity to all eligible Financial Institutions (both SDAs and PFIs) to participate and derive benefits from the projects which would in turn ensure that most needed MSMEs do receive assistance and at the same time, avoid including non-eligible MSMEs; (ii) sensitizing the participating PFIs under Component 2 to adopt and adhere to the WB's Environmental and Social Standards (ESS); and (iii) information, education and communication campaign to accomplish effective outreach so that all potential beneficiaries are fully aware of the project benefits and how to access them, and that all the stakeholders share a common understanding about the project.

53. The PIU will require close oversight on the ESMS implementation under the WB ESF, particularly in the early stages of implementation. At the MSME level, simple streamlined ES due diligence procedures that include screening against the prescribed eligibility criteria and compliance with national laws can serve as underlying framework for addressing ES risks and impacts. The PIU will submit

an evaluation report of each proposed PFI and its ESMS to the WB for no objection before the PFI can be included in the Project.

54. **Gender.** Female participation in SMEs will be further improved. Female participation in employment, in top management and in firm ownership in the Kyrgyz Republic is mostly higher than equivalent percentages for the region and economies with similar income levels. Nevertheless, there is a gender gap for small, medium and large firms (there is no data on female micro entrepreneurs). In particular, the percentage of firms with a female top manager or permanent full-time female workers in the productive segment is relatively low.

55. The project will aim to support female-headed firms by ensuring (via the outreach strategy) that female entrepreneurs have equal access to the RFA and potentially adjusting second-round financial institution participation on the basis of achieving gender-related thresholds. The project will also assist female entrepreneurs who do not already have an account at a financial institution to establish one. This would allow women to benefit from the RFA and the PRSF instruments. The project will measure the number of female headed MSMEs that receive RFA and credits guaranteed under the PRSF as an intermediate result indicator

56. **Stakeholder Engagement and Consultation.** The government recognizes the need for an effective and inclusive engagement with all of the relevant stakeholders and the MSMEs at large. Meaningful consultations and disclosure of appropriate information are essential to ensure that the most deserving are indeed 'included'. However, given the COVID-19 situation, it may not be possible to hold large face to face engagements and therefore reaching potential stakeholders throughout the country, especially entrepreneurs in the rural areas, will be a major challenge under the project. Against this backdrop, the project has prepared a Stakeholder Engagement Plan (SEP) which serves the following purposes: (i) stakeholder identification and analysis; (ii) planning engagement modalities viz., effective communication tools for consultations and disclosure in the context of COVID-19; (iii) enabling platforms for influencing decisions; (iv) defining roles and responsibilities of different actors in implementing the SEP; (iv) establishment of a grievance redress mechanism (GRM) for project activities; and (v) outlining the broader communications the project will support as part of project design.

57. **Project-Level Grievance Redress Mechanism**. Communities and individuals who believe that they are adversely affected as a result of this project, may submit complaints to the existing project-level GRM.

58. **Information Disclosure**. Once the WB has given its no objection to a PFI's ESMS, that PFI's ESMS will be disclosed by the MoF on its website in both English and Russian. This documentation will also be disclosed on the WB's and AIIB's websites.

59. **Independent Accountability Mechanism (IAM).** As noted above, the WB's ESF will apply to this project instead of AIIB's ESP. Pursuant to AIIB's CLA with WB, AIIB will rely on WB's corporate Grievance Redress Service (GRS) and its Independent Accountability Mechanism, the Inspection Panel, to handle complaints relating to ES issues that may arise under the project. Consequently, in accordance with AIIB's Policy on the Project affected People's Mechanism (PPM), submissions to the PPM under this project will not be eligible for consideration by the PPM. Information on WB's corporate GRS is available at http://www.worldbank.org/en/projects-operations/products-and-

services/grievance-redress-service. Information on WB's Inspection Panel is available at http://www.inspectionpanel.org.

D. Co-financier's Policies in Lieu of AIIB Policies

60. Pursuant to the decision of AIIB's Board of Directors set forth in the Decisions to Support the AIIB's COVID-19 Crisis Recovery Facility, given that this Project is being co-financed with the WB as lead co-financier, the WB's Policy on Investment Project Financing and other applicable policies of the WB, will apply to this project in lieu of AIIB's own operational policies.

E. Risks and Mitigation Measures

Table 2: Summary of Risks and Mitigating Measures

Risk Description	Assessment Ratings (High, Medium, Low)	Mitigation Measures
Political and governance risk. (i) Political uncertainty coupled with upcoming elections in October 2020. (ii) Persistent issues with rule of law and control of corruption.	Medium	(i) Strong alignment between Project activities and the government's COVID-19 response program. (ii) Plan to fast track approval of the Project before the elections. (iii) Working with an established PIU within MoF and working with existing agencies, like the GF.
Macroeconomic risk. Risk of the Government not meeting the financing needs of the short and mid-term response.	High	Potential donor budget support from IMF, ADB and other donors.
Sector strategies and policies risk. The government lacks the resources needed to support liquidity to the financial sector and/ or does not implement the complementary policies needed to ensure these investments have the intended impact.	High	The Government has in place an integrated COVID-19 response policy with measures that include support for MSMEs and the financial sector.
Technical design of the project risk. The Project will utilize a portfolio guarantee product	High	Capacity building workshops and awareness campaigns have already started and will continue

that is new to the market, with little time for capacity building and awareness raising.		during project implementation.
Institutional capacity risk. Use of instruments new to the Government, designed to respond to the COVID-19 crisis.	Medium	The Project will work with an experienced PIU within the MoF. The GF is also an experienced agency that cooperates with several International Financial Institutions. The Project will build capacity with implementing agencies to introduce these instruments.
Financial management risks. (i) emergency nature of the project; (ii) innovative nature of the project instruments; (iii) funds flow mechanism involving several channels before reaching the final beneficiaries; and (iv) risks and uncertainty due to impact of the COVID-19 pandemic.	High	Adequate mitigation measures to ensure that the residual project risk remains acceptable include: (i) a formal internal control framework in the Project Operational and Procedural Manuals; (ii) flow of funds mechanism via acceptable commercial bank(s); (iii) audit of the project financial statements by independent auditors and on terms of reference acceptable to AIIB and the WB; and, (iv) regular FM implementation support and supervision.
Environmental and Social. Limited direct environmental risks as the project will primarily finance MSMEs' liquidity needs. Possible social risks due to the project's focus on formal MSMEs and the challenge in ensuring small businesses in rural areas with less connectivity have equal access to funding under the project.	Medium	These risks are expected to be site-specific, temporary and can be addressed through standard mitigation measures and compliance with national laws. The implementing agency will ensure that the PFIs will be required to develop and implement an ESMS to classify and manage the ES risks of their financing activities.

		Proposed mitigation measures have been addressed in the WB Environmental and Social Commitment Plan (ESCP).
Stakeholder risk. PFI related risk.	Medium	Clear eligibility qualifications will be prepared for beneficiaries to ensure transparency and integrity.

Annex 1: Results Monitoring Framework

Project Objective:	To support micro, small and medium enterprises (MSMEs) in response to and during the recovery from the COVID-19 crisis.				
Indicator Name	**Unit of measure**	**Baseline** (2020)	**End Target** (2024)	**Frequency**	**Responsibility**
Project Objective Indicators:					
1. Share of MSMEs benefiting from the RFA that survive the COVID19 crisis (greater or equal to).	percentage	0	65	Annually	A dedicated M&E staff at the MoF PIU.
2. Share of MSMEs benefiting from the Portfolio Risk-Sharing Facility that survive the COVID-19 crisis (greater or equal to).	percentage	0	85	Annually	A dedicated M&E staff at the PIU working closely with the Guarantee Fund.
Intermediate Results Indicators:					
Component 1. Reimbursable Financial Assistance (RFA).					
a. Number of MSMEs that received RFA under the project.	Number	0	60,000	Annually	A dedicated M&E staff in the PIU
b. Number of jobs retained.	Number	0	65,000	Annually	A dedicated M&E staff at the PIU
c. Number of female headed MSMEs that received RFA.	Number	0	25,000	Annually	A dedicated M&E staff at the PIU
Component 2. Portfolio Risk Sharing Facility (PRSF).					

a. Number of MSMEs that benefited from the PRSF.	Number	0	5,500	Annually	A dedicated M&E staff at the MoF PIU.
b. Volume of MSME credits guaranteed under the PRSF.	USD	0	60,000,000	Annually	A dedicated M&E staff at the MoF PIU.
c. Number of female headed MSMEs that benefited from the PRSF.	Number	0	2,200	Annually	A dedicated M&E staff at the MoF PIU in coordination with the GF.
d. Leverage of financing.	Number	0	2	Annually	A dedicated M&E staff at the MoF PIU in close coordination with the GF.

Annex 2: Detailed Project Description

A. Component 1. Reimbursable Financial Assistance

1. This component aims to: (i) prevent business closures and the disruption of firms' relationships with employees, suppliers, customers and creditors; (ii) preserve private sector employment; and (iii) accelerate economic recovery. This component will finance eligible non-agricultural and fully privately-owned MSMEs, which will be required to repay the principal amount of the financial assistance.

2. Table 2.1 summarizes Component 1 sub-components, including rationale of support, eligibility criteria and terms of assistance. AIIB will only finance subcomponent 1.2 to SMEs.

Table 2.1: Summary of Component 1 sub-components

	Sub-component 1.1	**Sub-component 1.2**
Beneficiaries	Micro entrepreneurs working under simplified reporting requirements.	SMEs keeping accounting records and declaring their income and profitability.
Rationale	To keep subsistence businesses in the market so micro entrepreneurs retain their incomes	To prevent viable businesses from exiting the market disrupting the labor market and supplier relationships
Estimated size of beneficiary pool	Micro entrepreneurs: 87,550	Individual Entrepreneurs: 31,250[21] Small legal entities: 14,200 Medium legal entities: 800
Eligibility criteria	Evidence of one year of active operation and payment of social tax	• 1+ years of profitable operation shown by tax return • No uncontested arrears on tax or social payments • No negative marks on a credit report
Structure of assistance	Lump sum	Variable (based on number of employees)
Repayment terms	A few years after receiving RFA Partial forgiveness envisioned based on growth or formalization	A few years after receiving RFA

3. For Sub-component 1.2, to be financed by AIIB loan proceeds, further elaboration is found below:

4. **Eligible beneficiaries**: Legal and physical businesses that are keeping accounting records, paying taxes, and mostly have employees, suppliers, fixed premises, etc. Financial assistance will be provided for eligible SMEs, applying the tax committee definition of SMEs (i.e., revenue based on small firms earning less than KGS 8,000,000 (USD 108,000) and medium firms less than KGS 30,000,000 (USD 408,000)).[22] Additional eligibility criteria will be agreed upon and specified in the RFA

[21] This figure includes both 30,000 individual entrepreneurs registered as businesses with the State Tax Service (known as 'Certificate' IEs) as well as 1,250 individual entrepreneurs working through a special tax regime (known as 'Tax Contracts').

[22] Within this pool of potential beneficiaries, additional eligibility criteria will be applied to ensure financial assistance only reaches businesses that were healthy prior to the COVID-19 crisis.

Procedural Manual and may include: evidence of formal and profitable operation for at least a full calendar year; absence of undisputed arrears on tax or social contribution obligations as of January 31, 2020; and lack of negative comments in the Credit Bureau Ishenim as of January 31, 2020.

5. **Structure of assistance**: This will include a fixed component and a variable component linked to the number of formal employees. The specific amount will be defined in the RFA Procedural Manual to reflect both the potential size of the beneficiary pool and the amount of money needed to support employee salaries for a period of at least two months. Financial assistance will tentatively apply the following formula: [USD 500 + USD 300 * (number of full-time employees) to a cap of USD10,000].[23] Table 2.2 shows an estimated allocation of the RFA by type of beneficiary. In the event of higher than expected uptake, the financial assistance will be allocated on a first-come first-serve basis with disbursal conditions in place to ensure the Selected Disbursement Administrators (SDAs) are inclusive in reaching beneficiaries.

Table 2.2: Estimated coverage of RFA by type of beneficiary

	Micro entrepreneurs	Small firms		Medium firms
		Individual entrepreneurs	Legal entities	
Number of firms	87,550	31,250	14,520	769
Share of firms that apply	75%	80%	80%	90%
Share of eligible applicants	75%	60%	60%	75%
Number of beneficiaries	49,247	15,000	6,970	519
Average size of funding per firm	\$500 - \$600	\$1,400 - \$1,600	\$1,800 - \$2,000	\$9,000-\$10,000
Total Amount of RFA	**\$25 – 29 million**	**\$22 – 25 million**	**\$12 - 14 million**	**\$4.6 - 5.2 million**

Source: National Statistical Committee (2018), State Tax Service, WB estimation

6. **Eligible expenses**: The assistance will finance limited types of operational expenses, such as: (i) payroll costs; (ii) supplier invoices; (iii) rent; and (iv) utility expenses. The payments of these expenses will be prioritized following a "*cascade principle*" according to which the beneficiary will have to prove that the expenses in category (i) are fully completed before the financial assistance could be used for expenses in category (ii) and so on until the funding amount is fully exhausted. Any remaining proceeds will be returned.

7. **Electronic disbursement**: Expenses will be disbursed electronically and - wherever possible - directly into the recipient account.[24] Beneficiaries will be required to verify the use of funds for the eligible expenses through written invoices/payrolls. Beneficiaries without a financial account will be required to open one at the bank of their

[23] These figures would allow the assistance to reach all potentially eligible beneficiaries while retaining some flexibility to adjust the amount in the RFA Procedural Manual based on a precise estimate of the number of beneficiaries.
[24] The only expense for which cash payments are envisioned is payroll expenses for those employees without financial accounts.

choosing. Remote KYC procedures have been introduced in the Kyrgyz Republic, simplifying the process of opening new accounts.

8. **Repayment terms**: Beneficiaries will be required to repay the principle amount of the financial assistance in a few years. The PIU will be responsible to monitor repayment by beneficiaries.

Implementation arrangements for Component 1:

9. **Management of RFA**. The PIU will manage the RFA, maintaining an up-to-date database of beneficiaries, to track disbursements and ensure that no “double-dipping” takes place. This database will also include information from the financial assistance applications submitted by beneficiaries (and validated by SDAs) that will be used for monitoring and evaluation purposes. The PIU will also track repayment by beneficiaries.

10. **RFA disbursal agents**. SDAs will act as agents for disbursement of RFA based on a sub-agreement with the MoF. The government will propose a set of pre-selected SDAs, which will be subject to eligibility criteria screening, and ensure a nationwide coverage. SDAs will process a large number of potential beneficiaries and will be responsible to: (i) receive applications; (ii) verify eligibility of applicants; (iii) disburse financial assistance; (iv) verify that funds were used for the intended purposes; and (v) collect receipts if needed. To provide such services, SDAs will receive a fee to help them defray the costs associated with the disbursement of the financial assistance. One flat fee for each sub-component will be applied to discourage SDAs from prioritizing larger applicants.

11. Funds will be disbursed from the PIU to the SDAs in tranches based on the satisfactory performance of SDAs as disbursal agents (including for example, conditions on a minimum share of female headed firms or individual entrepreneurs served). Additional administrative costs will include outreach efforts to raise awareness among the beneficiary group of the program and the costs to conduct an audit on the use of the funds once they have been fully disbursed. These costs are included under the project management expenses in Component 3. Funds will be disbursed to beneficiaries based on a tripartite agreement with the MoF and the SDA. This agreement will also govern repayment of the financial assistance.

12. **Selection of SDAs**. The government will propose a set of pre-selected SDAs that will be screened against eligibility criteria. The group of SDAs will be selected to ensure full nation-wide coverage for the component.

B. Component 2. Partial Risk Sharing Facility

13. This component aims to incentivize lending by banks to viable businesses through the provision of a partial credit guarantee under a portfolio model. By sharing risk with PFIs, the PRSF aims to ensure continued credit flow to MSMEs during the COVID-19 crisis and improve MSMEs’ access to finance during the post-crisis recovery.

14. Under the portfolio approach, the guarantee will be applied to all credits meeting pre-defined eligibility criteria, offering: (i) systemic coverage, as the guarantee will be provided to a large portfolio of eligible credits; (ii) reduced processing time**,** as the

Guarantee Fund (GF) will not need to review applications at the individual credit level and will accept all credit meeting pre-defined eligibility criteria; and (iii) elimination of 'adverse selection' by Participant Financial Intermediaries (PFIs) as all eligible credits are automatically included under the guaranteed portfolio. Importantly, because the PFIs retain part of the credit risk, it is in their interest to carefully screen credit applications and select viable borrowers.

15. **Component 2 will include three windows**: (i) Window 1 - Portfolio guarantee to short-term loans and overdrafts (covering operating expenses of MSMEs such as salaries and rent); (ii) Window 2 - Portfolio guarantee to restructured credits that were in good standing before the crisis. The restructuring makes it easier for the borrower to repay its credit by lowering the interest rate, extending the term of the credit, etc., and (iii) Window 3 - Portfolio guarantee to new long-term loans to MSMEs to support their growth and development, especially in a post crisis environment.[25] Agreements will be signed by the GF with each PFI. The PRSF Procedural Manual for the operation of the windows will be attached to the convention.

16. **Management of the PRSF**. The GF (the only guarantee institution operating at the national level in the Kyrgyz Republic) will manage the PRSF and its three windows based on an agreement signed between the Ministry of Finance and the GF. This agreement will create the PRSF and its three windows, place the Project financing in the PRSF, and establish the GF as the manager of the PRFS. The Project financing will be earmarked for the operation of the PRSF.

17. The PRSF and its three windows will be separate from all the other activities of the GF. Each window will have its own separate accounting and its own funds, and there will be separation between the funds under the PRSF and existing capital of the GF. Income/Receipts will include (i) Commissions paid by the PFIs, (ii) Interest on the fund invested, and (iii) Recoveries on claims paid to PFIs. Cost/Expenditures will include (i) Administrative fees paid to GF, (ii) Fees paid to auditors, and (iii) Payments on claims. Capacity building will be provided to the GF, the PFIs and other stakeholders to operationalize the PRSF.

18. **Financial parameters.** As part of operationalizing the PRSF, the final decision regarding financial parameters, including commissions and other financial parameters of the fund, will be set in the PRSF Procedural Manual. The financial parameters include, *inter alia*:

- Commission fee: The PFIs will pay a commission fee to benefit from the PRSF coverage, which could be different for each Window. The pricing for Windows 1 and 2 will be set at a rate that would be acceptable to PFIs to support credit flow to MSMEs during the crisis. Given the uncertainty associated with the COVID-19 crisis, Windows 1 and 2 might incur losses. For Window 3, the fee will vary based on the claim ratio (defined as the volume of claims divided by the amount of credit guaranteed). More details will be specified in the PRSF Procedural Manual.

[25] This window could be extended to include both short-term loans and long-term loans after emergency support from Window 1 is closed. More details would be included in the PRSF Procedural Manual.

- Guarantee coverage: Coverage will be 50 percent for each credit for all windows. Currently, there is a 50 percent limit for the guarantee coverage set in the law (i.e., Law about Guarantee Funds in the KR, April 12, 2019, No.25). If the limit is increased through a law amendment, a guarantee coverage of 70-75 percent for windows 1 and 2 could be considered.

- Stop-loss: There are potentially two stop-loss mechanisms. First, once a certain level of claim ratio (defined as the volume of claims divided by the amount of credit guaranteed) is reached, the PFI will not be able to enter further credits in the guarantee. Second, at a higher level of claim ratio, the window will stop paying against claims.

- Maximum guarantee amount allocated for each PFI: A maximum amount may be set for the guarantee for each PFI under the three windows, above which no new credits will be entered into the guarantee portfolio. The PFI may be charged a commitment fee for the allocated guarantee amount. The GF could change the threshold periodically across the PFIs based on the uptake.

- Leverage: A multiplier of two will be applied to the funds under each window. This means that with a risk sharing of 50-50, the total amount of credit guaranteed could be four times the allocated funds.

19. **PRSF coverage.** The estimated scale of project support through PRSF can be found in Table 2.3. The financing for PRSF will be sufficient to guarantee the majority of MSME credits up to a reasonable threshold set at around one and a half times the median size of firms' outstanding balance of credits before the crisis. Table 2.3 shows that there are around US$76 to 89 million loans to be guaranteed during the crisis across the three windows. With a guarantee coverage of 50%[26] and the leverage of 2 (1 dollar of financing provide 2 dollars of guarantee), this will require around US$20-25 million of financing, which will be covered by project funding for PRSF.

Table 2.3: Estimated Coverage of the PRSF (Component 2)

	Micro entrepreneurs	Small firms		Medium firms
		Individual entrepreneurs	Legal entities	
Number of Firms	87,550	31,250	14,520	769
Share of Firms with Access to Finance	3%	10%	17%	35%
Out of which, share receiving guarantee	60%	70%	70%	70%
Number of Firms with Access to Finance	1,575	2,188	1,728	188
Average Guarantee Amount: based on one and a half times the Median Size of Firms' Total Outstanding Balance of Loans and Lines of Credit (US$)	$2,000 - $2,500	$18,000 - $20,000	$22,000 - $25,000	$40,000 - $50,000

[26] In the Law on Guarantee Funds in the Kyrgyz Republic, the guarantee risk sharing threshold is set at 50 percent of the principal amount of financing. A proposal to amend the law has been submitted to increase the threshold to 75 percent.

Guaranteed loans (US$)	$3 -4 million	$40 – 44 million	$39 – 44 million	$8 – 10 million
Guaranteed portion (50% of guaranteed loans)	$1.5-2 million	$20 – 22 million	$20 – 22 million	$4-5 million
Capital required (50% of guaranteed portion)	**$1 million**	**$10 – 11 million**	**$10 – 11 million**	**$2 – 2.5 million**

Source: National Statistical Committee (2018), State Tax Service, World Bank Enterprise Survey (2019), WB estimation

20. **Credit registration process (automaticity).** The PFI analyzes each credit request and decides whether or not to extend the credit. Under the principle of "automaticity", all eligible credits by the PFIs must be automatically registered in the guaranteed portfolio, without it being possible for either the PFIs or the GF to exclude particular borrowers or credits. By automatizing and keeping this process nimble, the PRSF reduces the administrative burden to all participants and ensures quick settlement. In addition, borrowers are not informed that their borrowing is partially guaranteed (the PRSF is "silent"), reducing moral hazard.

21. **Claim settlement process.** If a credit guaranteed under one of the windows defaults, the PFI will submit a claim to the GF that will swiftly process the payment. Defaults will be defined in the PRSF Procedural Manual and will be aligned with the definition provided by the NBKR. Within 30 (thirty) calendar days, the GF will review and settle the claim. The quick payment is an important benefit for PFIs that receive cash immediately without having to wait for a lengthy settlement process. The PFI will remain in charge of the recovery and the resulting proceeds will be proportionally shared with the PRSF.

22. To allow mobilization of additional financing for the PRSF, the PRSF will be set up in a flexible way to enable participation from other donors and development partners. IDA and AIIB are co-financiers during this initial set-up of the project, but other financiers may participate in the future.

23. **Sunset clause for Windows 1 and 2.** Windows 1 and 2 are a direct response to the COVID-19 crisis and the commission fee will be set at an acceptable level to PFIs in order to encourage uptake and support continued credit flow to MSMEs during this period. The two windows are temporary in nature and will close after operating for a defined period, i.e. PFIs will be able to enter credits only for a limited period of time. Windows 1 and 2 provide emergency support during the crisis and are expected to be closed and potentially migrated to sustainable operation during the post-crisis period.[27]

24. **Window 3 expected to operate on a commercial basis.** For Window 3, the commissions paid by PFIs and the returns on investments of the endowment are set at a level to cover the operational costs and net losses related to the payments of claims. This design should contribute to maintaining the endowment of the third window at its original level. Window 3 is expected to support post-crisis recovery and could be operated beyond the duration of the project.

[27] For example, PFIs will be able to enter credits for a period of 12 months after the start of Window 1, and 18 months for Window 2. Once window 1 closes, short-term loans will be registered under Window 3 (instead of Window 1).

25. **Eligibility for PFIs and credits.** PFIs will be chosen through calls for expression of interest. All PFIs and credits will have to meet the eligibility criteria that will be specified in the PRSF Procedural Manual, including, *inter alia*:

Table 2.4: Eligibility criteria for PFIs and Credits

Eligibility for PFIs	Eligibility for Credits
- Meeting prudential norms set by NBKR - Sound financial performance: • Has a reasonable ratio of NPLs • Has reasonable Return on Assets and Return on Equity; - Sufficient capacity to serve MSME clients and participate in the PRSF: • Is engaged in lending to MSMEs or has expressed an interest to develop lending activities towards MSMEs; it has obtained all the authorizations to that effect from its Board of Directors and has the necessary means to conduct such activity • Has a dedicated staff for the management of a MSME clientele • Has credits procedures covering analysis of loan requests, loan granting, loan monitoring and loan recovery • Has implemented an automated credit information system • Has a reporting system on credits by type of borrowers, sector of activity, geographic zone, or will be able to adapt its existing system to develop such reporting • Commits to maintain a financial management system and to prepare financial statements in conformity with usual accounting norms; these financial statements must be audited and certified by licensed auditors	- Borrowers/firms must meet the following: • Firms must be categorized as individual entrepreneurs, small firms or medium firms • Firms must be profitable before the COVID-19 crisis • Firms must have paid interest and principle regularly before the crisis - Size of credit: each eligible credit must have size below pre-determined threshold. Credits with size above the threshold will not be eligible for coverage in the PRSF. - In addition, each window will have separate eligibility criteria, including, inter alia: • Window 1: short-term loans and overdrafts. • Window 2: the restructured credit must have better terms than the original credit, such as longer maturity and lower interest rate. • Window 3: new long-term loans.[28] - In addition, credits from certain firms (such as firms in the tobacco industries) or used for certain activities (such as those posing significant environmental and social safeguard risk) will not be eligible for the guarantee.

[28] When Window 1 is open, Window 3 will register long-term loan (e.g. with maturity more than 12 months). When Window 1 closes, Window 3 could potentially be open to both short-term and long-term loans. More details will be included in the PRSF Procedural Manual.

• Has the capacity to achieve the performance indicators agreed upon in the agreement between the PFI and the SGF • Has (or commits to put in place) anti-money laundering and anti-terrorist policies as well as a policy of social and environmental responsibility in conformity with similar policies at the World Bank, and gender policies, and will integrate these policies in the operational procedures of the institution	

26. **Regulation and supervision of the PRSF** rests on the NBKR. Any additional capital relief for loans guaranteed under the portfolio approach would also be discussed with the NBKR.

27. External audits of the three windows and of the PFIs will be conducted semi-annually. With respect to the PFIs, the audits will ensure that the PRSF is operating in accordance with the agreement between GF and PFIs and the PRSF Procedural Manual. In addition, the audit will verify that the PFIs are actively conducting loan recoveries. Corrective actions by the GF will be defined in the PRSF Procedural Manual for PFIs not passing the external audit.

28. A steering committee composed of representatives from Government and private sector will monitor the operations of the three windows, and will ensure that these operations follow the PRSF Procedural Manual.

29. **Financial model simulations** were conducted for the PRSF to assess the gains and losses during the project under different scenarios (Table 2.5). Given the COVID-19 situation, the commission fees for Windows 1 and 2 under the PRSF need to be kept at a level acceptable to PFIs to incentivize financial institution participation. The simulations incorporating a commission fee equal to the fee on individual loan guarantee products currently offered by the GF show that most of the project funds will still be retained by the end of the project: (i) in the baseline scenario, 95 percent of the project financing for the PRSF will be retained by the end of the project; (ii) In the high distress scenario, 71 percent of the project financing for the PRSF will be retained by the end of the project; and, (iii) In the low distress scenario, 114 percent of the project financing will be retained by the end of the project, i.e. the PRSF will be profitable.

30. Simulation results are highly sensitive to leverage. With a leverage of three (one dollar in PRSF provides three dollars of guarantees), only 80 percent of project financing will be retained by the end of the project in the baseline scenario (as opposed to 95 percent when leverage is set at two). Increasing guarantee coverage does not significantly affect expected loss of project financing – with a higher guarantee coverage (e.g., at 75 percent), with the same leverage, the total amount of loans guaranteed will be smaller, thus the total expected loss remains unchanged.

Table 2.5: PRSF Financial Model, in thousands USD

			Year 1	Year 2	Year 3	Year 4
INPUTS: Baseline Scenario						
A	IDA disbursement for guarantee		12,000	7,200	2,400	2,400
A.1	IDA disbursement, cumulative		12,000	19,200	21,600	24,000
B	Leverage (x times)		2	2	2	2
C	Guarantee coverage (%)		50%	50%	50%	50%
D	Portfolio in distresses (claim as % of portfolio)		15%	10%	8%	6%
E	Recuperation (% of last period's payout of guarantee)		-	15%	15%	20%
F	Return on invested assets (%)**		10%	10%	10%	10%
G	Operating costs		50	50	50	50
H	IDA coverage of operational costs (%)		100%	100%	100%	100%
OUTPUTS: Baseline Scenario						
K	SGF funds (beginning of period)	A+U(-1)*	12,000	17,280	19,183	21,718
J	Portfolio of loans (under guarantee)	K*B/C	48,000	69,120	76,733	86,872
L	with guarantee	K*B	24,000	34,560	38,366	43,436
M	w/o guarantee	J-L	24,000	34,560	38,366	43,436
N	Portfolio in distresses	J*D	7200	6912	6,139	5,212
P	Payout by SGF	N*C	3600	3456	3,069	2,606
Q	Recuperation of last period's payout by SGF	P(-1)*E	0	540	518	614
R	Administrative costs not covered by IDA	G-G*H	0	0	0	0
S	Return from invested SGF funds	K*F	1,200	1,728	1,918	2,172
T	Proceeds from the commission charged by	L*G	480	691	767	869
U	SGF funds (at the end of period)	K-P+Q-R+S+T	10,080	16,783	19,318	22,766
V	(Loss) Gain in SGF Funds during the Period	U-K	(1,920)	(497)	135	1,048
W	(Loss) Gain in SGF Funds vs IDA cumulative disbursement	U-A.1	(1,920)	(2,417)	(2,282)	(1,234)
High Portfolio in distress Scenario						
	Portfolio in distress (% of Portfolio)		25%	20%	10%	8%
	SGF funds (at the end of period)		7,680	11,911	14,345	16,983
	(Loss) Gain in SGF Funds during the Period		(4,320)	(2,969)	34	238
	(Loss) Gain in SGF Funds vs IDA cumulative disbursement		(4,320)	(7,289)	(7,255)	(7,017)
Low Portfolio in distress Scenario						
	Portfolio in distress (% of Portfolio)		10%	8%	4%	3%
	SGF funds (at the end of period)		11,280	18,470	22,566	27,297

	(Loss) Gain in SGF Funds during the Period		(720)	(10)	1,696	2,331
	(Loss) Gain in SGF Funds vs IDA cumulative disbursement		(720)	(730)	966	3,297

*Note: (-1) means the variable in the previous period.

**One-year deposit rate is 10% – 12.5% in the Kyrgyz Republic. Guarantee will be provided to local currency

Annex 3: Sovereign Credit Fact Sheet

A. Recent Economic Development

1. Kyrgyz Republic is a lower-middle-income country with a GDP per capita of around USD1,300 and a population of 6.5 million in 2019. The country is endowed with mineral deposits and forests and has the potential to expand into hydroelectricity production and tourism industry.[1]

2. Before the pandemic, economic performance had been positive. GDP growth increased from 3.5 percent in 2018 to 4.5 percent in 2019, on the back of higher output in both the gold and non-gold sector. Inflation in 2018 and 2019 was 1.5 and 1.1 percent respectively, well below the central bank's target range of 5 to 7 percent. The fiscal deficit decreased from 0.6 percent of GDP in 2018 to 0.1 percent in 2019, and this led to the reduction in public debt from 54.8 to 54.1 percent in 2019.

3. As for the external sector, the current account deficit narrowed from 12.1 percent of GDP in 2018 to 9.2 percent in 2019, driven by higher gold export and lower imports. Gross official reserves stabilized at 4.5 months of imports in 2019, an increase compared to the 3.9 months of imports in 2018. The exchange rate had been stable at around 69 KGS/USD since mid-2016 till March 2020.

B. Economic Indicators

Key Economic Indicators 1/	2017	2018	2019	2020*	2021*
Real GDP growth (%)	4.7	3.5	4.5	-4.0	8.0
CPI Inflation (average, % change)	3.2	1.5	1.1	10.6	7.2
Current account balance (% of GDP)	-6.2	-12.1	-9.1	-13.1	-8.9
General government overall balance (% of GDP)	-3.7	-0.6	-0.1	-8.8	-6.4
Nominal gross public debt (% of GDP)	58.8	54.8	54.1	69.0	67.9
Public gross financing needs (% of GDP) 3/	4.6	1.7	-1.0	19.4	17.1
Gross external debt (% of GDP) 3/	81.1	76.5	76.4	89.9	85.0
Gross external financing need (% of GDP) 3/	13.6	13.6	18.5	8.3	18.6
Gross international reserves (in months of imports)	4.0	3.9	4.5	4.5	4.7
Broad money growth (M2, %)	17.9	5.5	12.8	9.3	35.3
Exchange rate KGS/USD (EOP) 2/	68.8	69.7	69.5	74.9	...

Source: IMF Country Report No. 20/158.
1/ Data for 2017-19 are actuals; 2020-21 are projections; 2/ Kyrgyzstan's currency is the som (KGS). FX rate for 2020 is from Refinitiv Eikon, as of June 22; 3/ Source: IMF Country Report No. 20/90, except for 2020-21: AIIB staff projections based on IMF assumptions

C. Economic Outlook and Risks

4. The COVID-19 pandemic has weakened the macroeconomic outlook of the Kyrgyz Republic significantly. To curb the pandemic, the government implemented strict border restriction and nation-wide curfew in March, which led to economic disruptions. The

[1] World Bank, Kyrgyz Republic Country Snapshot, April 2020

economy is expected to shrink by 4 percent in 2020 due to the contraction of industry, transport, construction, and retail trade. Inflation is expected to reach 10.6 percent in 2020, due to the disruption in agriculture production[2] and transport system, together with depreciation and more costly imports. In the external sector, increased trade deficit as well as declining remittances and tourism revenues are contributing to a widening of the current account deficit, to as much as 13 percent of GDP expected in 2020.

5. During the first half of 2020, the central bank intervened in the foreign exchange market by selling over USD200 million of foreign exchange reserves, to prevent disorderly market conditions.[3] The exchange rate depreciated initially by 20 percent, but has since regained two-thirds of the losses and stabilized at around 75 KGS/USD, as of June 25. Gross international reserves are projected to remain stable at around 4.5 months of imports in 2020 and rise slightly to 4.9 months of imports in the medium term.

6. The fiscal deficit is expected to widen to 8.8 percent of GDP in 2020, due to declining tax revenues at customs, declining remittances, and expanded public health expenditure. With higher fiscal deficit, public debt is estimated to increase to 69 percent of GDP in 2020, and the external debt is also expected to rise to around 85-90 percent of GDP.[4]

7. The state of emergency ended on May 10, and international flights resumed on June 15.[5] Looking forward, under the assumption that the pandemic can be contained by mid-2020, economic growth is expected to bounce back to 8 percent, and inflation to fall to about 7 percent in 2021. Trade is expected to recover as the country reopens its economy, and the current account deficit is projected to narrow to 9 percent of GDP in 2021.

8. Kyrgyz Republic's public debt remains sustainable, though the risk of debt distress is assessed as moderate.[6] Debt sustainability is conditional on the return to fiscal prudence in the medium term (i.e., fiscal deficit below 3 percent of GDP, as per the authority's plans) and continued access to concessional financing. Under such scenario, the total public debt is expected to decline to about 60 percent of GDP, with external debt expected at around 75-80 percent of GDP in 2025.

[2] FAO, Locust Emergency in Kyrgyzstan, May 2020

[3] NBKR foreign currency interventions. https://www.nbkr.kg/index1.jsp?item=114&lang=ENG

[4] A major part external debt is public and publicly guaranteed debt

[5] IMF Policy Response Tracker https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#K

[6] See IMF Country Report No. 20/90. Kyrgyz Republic—Staff Report for Purchase under the RFI and disbursement under the RCF—Debt Sustainability Analysis. https://www.imf.org/en/Publications/CR/Issues/2020/03/27/Kyrgyz-Republic-Request-for-Purchase-Under-the-Rapid-Financing-Instrument-and-Disbursement-49296

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