

BANKING SITUATION IN UZBEKISTAN



BANKING ISSUE IN UZBEKISTAN

Background

On February 4th 2004, the Government of Uzbekistan issued decree #56 dated February 4th, '04, which stated that all grant paying organizations and grant receiving entities (individuals and institutes) operating in Uzbekistan are required to bank with one of two banks (both state owned): The National Bank for Foreign Activity of Uzbekistan (NBFAU) and Asaka Bank. Unfortunately, the STCU did not bank with either of these two banks, and on February 19th '04 was forbidden by its bank at the time (Uzpromstroybank) to make any more grant and overhead payments to STCU projects in Uzbekistan.

During the course of March and April '04, the STCU negotiated with both the NBFAU and Asaka Bank in order to restart operations with either of these two banks. The STCU did not open a bank account with either of these two banks because they both refused to allow the STCU to make payments in hard currency (USD and Euro) to grantee scientists and institutes. Furthermore, both banks refused the STCU's request to open a local currency account in order to make administrative payments for the Tashkent regional office.

The management of the STCU has taken a position that payments to STCU grantees and institutes in local Uzbek currency (Tsum) is unacceptable, because of wording in its statute that provides STCU the right to pay in hard currency or local currency. Thus, according to Article XI (Contributions of the Center) Section F, the Center has the right to make payments in whatever currency it chooses. Please see below for the relevant section of the Statute discussing this matter.

ARTICLE XI

(Contributions to the Center)

- F. Disbursements of funds for projects may be made to the appropriate organizations and individuals in hard currency or local currency.

Thus, at the end of April '04, after unsuccessful attempts to negotiate with the two aforementioned banks, the STCU began transferring hard currency from its bank accounts in New York and Brussels directly to the grantee and institute accounts in Uzbekistan. This was a short-term fix in order to restart the payment process, while the STCU worked with the Government of Uzbekistan to provide a suitable solution to the issues brought about by decree #56. This system has proven successful as a short-term fix, allowing the STCU to continue to make payments to its grantees in USD and Euro.

The major drawback of making transfers from New York and Brussels is its cost. The cost for working under the new system versus the old system is resulting in a monthly increase of \$1,500 to \$2,000 (depending on the number of transactions) in costs in the the Bank Fees – Offshore account.

In addition to the added cost, STCU grantees have experienced significant delays (from 1 – 2 months) in receiving their grant, travel, and overhead payments. Thus, the STCU project participants have suffered as a result of this new decree as well.

STCU's Efforts to Resolve the Situation to Date

As mentioned, during March and April '04, the STCU Finance Department unsuccessfully attempted to negotiate with both NBFAU and Asaka to allow the STCU the banking conditions necessary to continue to pay its recipient scientists and institutes in hard currency.

After those discussions failed, on April 30, '04, the Uzbekistan Information Officer, CFO and DED (USA) met with the Uzbek Ambassador in Kyiv and explained the problem. Sympathizing with our position, he offered to contact the Uzbek MFA and arrange a meeting with the appropriate person for our Information Officer.

As a follow-up to the meeting with the Uzbek Ambassador, the STCU sent a letter dated May 24, 2004 to the MFA of Uzbekistan (see attached) asking for their assistance in helping the STCU to resolve its banking situation.

After some delays, in mid-August '04, a meeting was held with the STCU Information Officer and MFA representatives: Mr. Zafar Ahmedov, Head of Accreditation Department and Gulom Uralov, Third Secretary of Accreditation Department to discuss the points raised in the STCU's letter. As a result of the meeting, Mr. Akhmedov informed that he will give a report to Mr. Vladimir Norov, Senior Deputy of Minister of Foreign Affairs RU, as well as the MFA will send a formal letter to the Central Bank of the RU on behalf of the STCU.

In late September/early October, Andrew Hood, STCU Executive Director, headed an STCU delegation to Uzbekistan, which had as one of its agenda items to work with the Government of Uzbekistan and STCU Funding Party Representatives on this matter. In Tashkent, the delegation met with representatives of the United States Embassy in Tashkent (Ambassador Jon Purnell and Tracey Newell, Political/Economic Officer), who are attempting to meet with Deputy Prime Minister Azimov, the person in charge of implementing the Decree, to specifically address the STCU's issues as a follow-up to two diplomatic notes (which mentioned the STCU as one of the organizations affected by decree #56) that were sent to him. Furthermore, Mr. Hood met with representatives of the Government of Uzbekistan (Prof. Ali Akhunov, Deputy Director of the Center for Science and Technology, Academician Bekzod Yuldashev, President of the Academy of Sciences in Uzbekistan, and Mr. Norov, Senior Deputy Minister in the Ministry of Foreign Affairs), who stated their support for the STCU and the importance of STCU activities in Uzbekistan. All expressed their assistance in trying to resolve the problems encountered by the STCU in re-establishing banking agreements in compliance with the Cabinet of Ministers decree. During meetings with the Government of Uzbekistan, the ED raised the following main points:

1. The STCU is a known organization within Uzbekistan and, unlike a non-government organization or foreign development assistance agency, the Government of Uzbekistan was a key member of the STCU's intergovernmental governing bodies. The STCU had diplomatic accreditation that had been recently renewed by Uzbekistan. Further, the STCU had conducted over \$10 million in projects in Uzbekistan since 1997, so the previous Uzbek-STCU banking arrangements had been effective and acceptable to all parties. The lack of such effective banking arrangements now was making it increasingly more complex and expensive for the STCU to work in Uzbekistan, which would negatively impact STCU's ability to continue and expand its activities in Uzbekistan and with Uzbek scientists.
2. The STCU had been trying to come to agreement with either of the two Uzbek banks on terms that would comply with the Uzbek law and retain the STCU's rights as a diplomatic entity in Uzbekistan as well as the financial transaction rights it had with its previous Uzbek bank. In the view of the STCU, there was no contradiction in complying with the new Uzbek decree and retaining the financial arrangements it had previously in Uzbekistan.

3. In spite of STCU efforts to conduct good-faith negotiations with the two designated Uzbek banks, officials at these banks were not willing to give the STCU the same banking arrangements it had with its previous Uzbek bank. The ED felt that attention from senior level Uzbek government officials was necessary to encourage the bank officers and Central Bank officials to work more constructively with the STCU financial officers and come to a resolution quickly.

Mr. Norov, Senior Deputy Minister, MFA RU, expressed a specific willingness to engage officials at the Central Bank directly to press for a resolution of the STCU banking situation, and he requested that the STCU send him a letter giving the details of the STCU banking requirements.

As a result of the ED's meetings with Mr. Norov, the STCU provided a letter to him with a detailed attachment explaining the STCU's position on the Uzbek banking situation. Please see attached to this report the document entitled "STCU Position on Uzbek Banking Situation". This letter was cc:d to the following individuals as well: Acad. Khabibullaev, Director of the Science and Technology Center, Cabinet of Ministers RU and Acad. Yuldashev, President of the Academy of Sciences RU.

Furthermore, there were additional meetings with the STCU's Regional Officer in Uzbekitan (Ms. Regina Sattarova) the following Government of Uzbekistan officials to further discuss the STCU's Position on Uzbek Banking Situation": Acad. Yuldashev, Dr. Egamberdiev and Deputy Advisor on Science and Technology, President Administration RU

As of the printing of this report, the status of the banking issue in Uzbekistan remains open with the STCU working with representatives of the American Embassy in Tashkent and the Government of Uzbekistan to bring the situation to an acceptable resolve for both the STCU and the Government of Uzbekistan.

Request to the Advisory Committee in September '04

As a result of this unforeseen increase in bank fees, the STCU was forecast to exceed its 2004 budget allocated for Bank Fees – Offshore by approximately \$20K - \$25K. Thus, the management of the STCU requested that the Advisory Committee in September '04 in Ottawa allow the STCU to move budget money between lines and decrease the Contingency – Non Recurring from \$25K to \$0 and move the funds to increase the Bank Fees – Offshore by the same \$25K. This would keep the total overall budget for 2004 unchanged at \$1,726,214, and allow the STCU to cope with this unforeseen situation while continuing its efforts with the Uzbek and Funding Party authorities to resolve the situation. The Advisory Committee agreed and this decision will be formalized in the Record of Decisions of the the 19th STCU Governing Board.

STCU POSITION ON UZBEK BANKING SITUATION

Purpose:

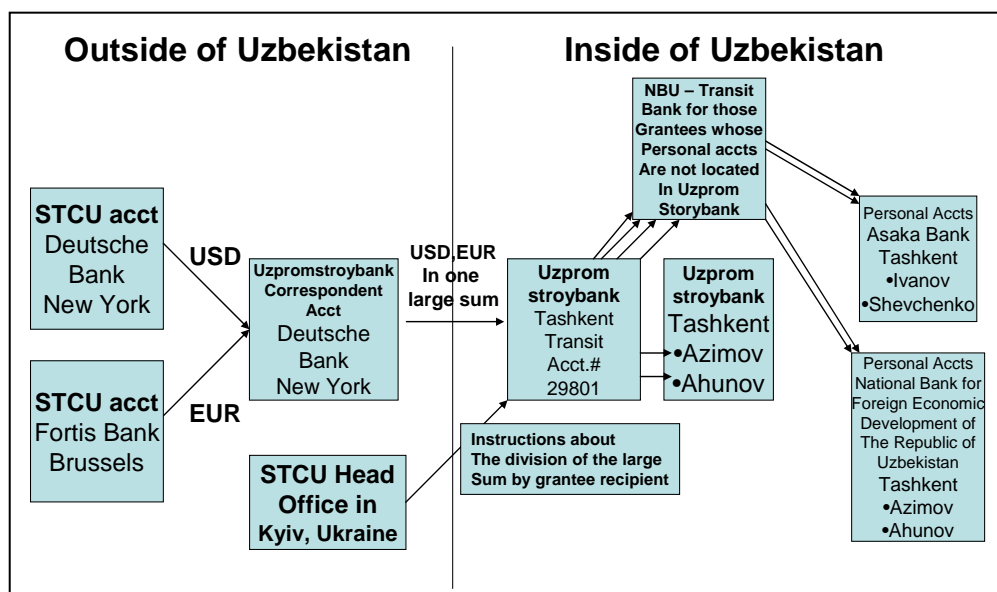
In order to clearly and precisely communicate the history of the situation, STCU's understanding of its options to date, and STCU's suggested remedy to the situation.

History Prior to Decree #56

Before going into the history surrounding the impact of the Government of Uzbekistan's Decree #56, it seems pertinent to discuss the STCU's banking operations in place before decree #56. Furthermore, in order to further the reader's understanding of the STCU's banking operations, it is necessary to divide the STCU's banking operations into its three component parts: 1). Payments for Project Grants and Overhead paid directly to the scientists and institutes, and 2). Payments to Vendors for project equipment, materials, etc. on behalf of its projects, for delivery and consumption by the project. 3). Payments to Vendors for Administrative requirements of the STCU Regional Information Office in Tashkent. Those are the three main categories of transactions. Prior to Decree #56, the STCU utilized the following methods for paying the three main payment categories:

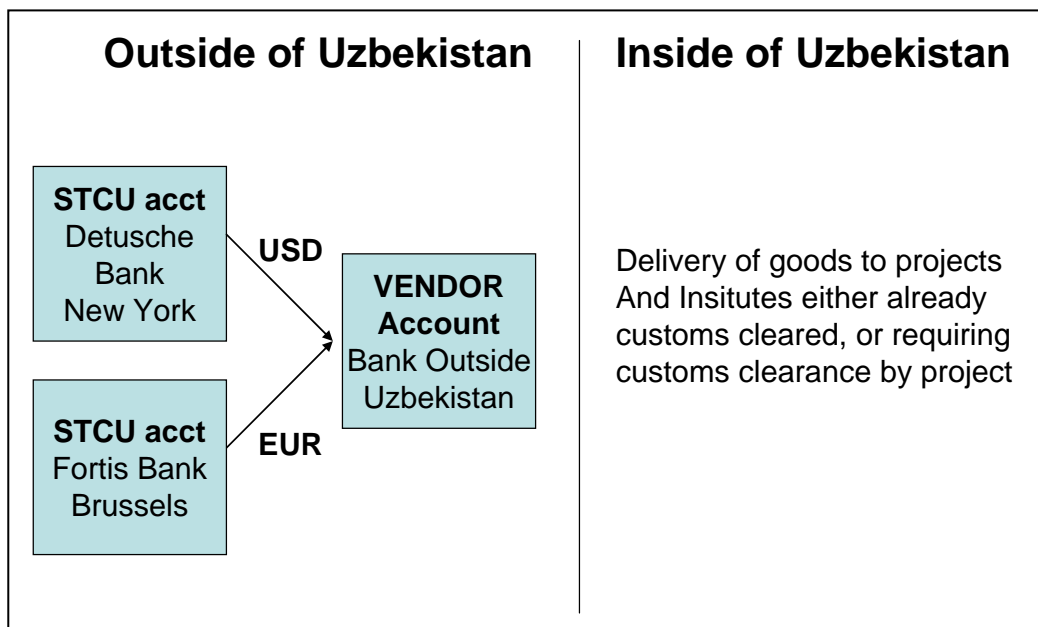
1). Project Grants and Overhead – Prior to Decree #56, as well as currently, the STCU maintains its two main hard currency accounts in two offshore (outside of Uzbekistan) banks: Deutsche Bank, New York, for USD; and Fortis Bank, Brussels, for EUR. All project money for Uzbekistan (for other recipient countries as well) is held in either of these two banks, until the time comes to make disbursements.

In addition to the two banks mentioned above, the STCU also maintained an agreement with Uzpromstroybank which allowed the STCU to make payments to grantees and institutes in USD and EUR. This agreement with Uzpromstroybank was in effect until the implementation of Decree #56 (agreement was unilaterally terminated by bank in mid-February '04). Thus, with these three banks, the STCU paid grantee scientists and institutes in hard currency in the following manner:



As you can see from the diagram above, the STCU sent hard currency from its accounts in New York and Brussels, to the account of Uzpromstroybank in Deutsche Bank New York. Then Uzpromstroybank transferred the money to its Headquarters in Tashkent, where it credited the hard currency funds to those grantee scientists accounts who maintained accounts within Uzpromstroybank (approx. 50% of STCU’s scientists and institutes maintained their accounts there), or transferred the hard currency funds on to other banks (i.e. Asaka Bank, NBFAU, etc.) where those remaining grantee scientists and institutes maintained their accounts. The key feature of this system was that the STCU never had a bank account in Uzpromstroybank, just a banking agreement that stated the STCU would send hard currency to Uzpromstroybank’s hard currency accounts in Deutsche Bank New York, and then Uzpromstroybank would transfer the funds to grantee and institute accounts in banks located in Uzbekistan, according to faxed instructions from the STCU Headquarters to Uzpromstroybank’s headquarters in Tashkent.

2). Project Vendors – Prior to Decree #56, as well as currently, all payments to vendors for equipment, materials, etc. to be used by STCU projects and institutes located in Uzbekistan were made to offshore bank accounts, with goods delivered to the projects already customs cleared or requiring the project to provide customs clearance procedures. See below for a diagram of this payment procedure:



3). Administrative payments for STCU Regional Office in Tashkent – Prior to Decree #56, as well as currently, all payments to vendors for equipment, materials, etc. to be used by the STCU information office followed the same procedure detailed in item #2 – Project Vendors above.

Thus, to summarize, the STCU prior to Decree #56 never had a bank account in a bank located in Uzbekistan. Furthermore, the STCU never had a local currency bank account. The reason for the lack of a local currency account as well as for the payment of grantee scientists and institutes in USD was because the STCU’s project agreements were (and still are) denominated in USD and EUR, as well as the STCU’s desire to minimize the exchange fees and gains/losses related to paying in local currency.

History after Decree #56

On February 4th 2004, the Government of Uzbekistan issued decree #56 dated February 4th, '04, which stated that all grant paying organizations and grant receiving entities (individuals and institutes) operating in Uzbekistan are required to bank with one of two banks (both state owned): The National

Bank for Foreign Activity of Uzbekistan (NBFAU) and Asaka Bank. Unfortunately, as mentioned above, the STCU did not bank with either of these two banks, and on February 19th '04 was forbidden by its bank at the time (Uzpromstroybank) to make any more grant and overhead payments to STCU projects in Uzbekistan.

During the course of March and April '04, the STCU negotiated with both the NBFAU and Asaka Bank in order to restart operations with either of these two banks. The STCU did not open a bank account with either of these two banks because of their inflexibility to accommodate the needs of the STCU.

Thus, at the end of April '04, after unsuccessful attempts to negotiate with the two aforementioned banks, the STCU began transferring hard currency from its bank accounts in New York and Brussels directly to the grantee and institute accounts in Uzbekistan. This was a short-term fix in order to restart the payment process, while the STCU worked with the Government of Uzbekistan to provide a suitable solution to the issues brought about by decree #56. This system has proven successful as a short-term fix, allowing the STCU to continue to make payments to its grantees in USD and Euro.

The major drawback of making transfers from New York and Brussels is its cost. The cost for working under the new system versus the old system is resulting in a monthly increase of \$1,500 to \$2,000 (depending on the number of transactions) in costs in the the Bank Fees – Offshore account.

STCU's Banking Requirements

In order to understand the negotiations that have been conducted, as well as the position of Asaka Bank, the NBFAU, and the Central Bank, it is important to clearly and precisely define what are the STCU's banking requirements. Furthermore in order to define the STCU's requirements, it is important to know that the STCU is comprised of two separate and distinct organizations: STCU headquartered in Kyiv and STCU Regional Information office located in Tashkent (accredited by MFA). In some countries, it is possible for a legal entity to open a bank account with a bank located in a country where the legal entity is not located. For example, the STCU has accounts in Belgium and New York, but the STCU headquarters is located in Kyiv, Ukraine. Thus, having made this important point, below are the Banking Requirements of the STCU that would need to be accommodated by Asaka Bank or the NBFAU:

- 1). The STCU wants to be excluded from having to perform any kind of financial reporting (i.e. tax reports, etc.) to the Government of Uzbekistan. The reason why the distinction between the two STCU organizations was made above was because of this requirement. In most countries, non-resident organizations are not required to perform financial reporting to the government where the bank account is located. Thus, a possible solution to this requirement is to have bank accounts opened in the name of the STCU Headquarters.
- 2). The STCU wants the ability to open USD, EUR and Tsum accounts.
- 3). The STCU wants the ability to make payments from the hard currency accounts in USD and EUR to project grantees and institutes directly into their hard currency accounts for grant and institute payments. As mentioned above, the STCU wants to pay in hard currency because the STCU's project agreements were (and still are) denominated in USD and EUR, as well as the STCU's desire to minimize the exchange fees and gains/losses related to paying in local currency.

Furthermore, the STCU, because of wording in its statute, feels that it has the right to pay in hard currency or local currency. Thus, not only is it prudent because of the Govt. of Uzbekistan's prior manipulations of the exchange rate to utilize hard currency, but also according to Article XI (Contributions of the Center) Section D, the Center has the right to make payments in whatever currency it chooses. Please see below for the relevant section of the Statute discussing this matter.

ARTICLE XI

(Contributions to the Center)

F. Disbursements of funds for projects may be made to the appropriate organizations and individuals in hard currency or local currency.

4). The STCU wants the ability make to make payments to Uzbek vendors in Tsum for all types of purchases (including administrative and project purchases).

Response of Government of Uzbekistan (Central Bank, NBFAU, Asaka and MFA) to the STCU's Requirements

Over the course of the last months, the STCU has met with representatives of the MFA, Central Bank, Asaka, and NBFAU in order to discuss the STCU's requirements, and how they work with the legislation of the Government of Uzbekistan. Below is a summary of the results of these conversations.

1). Opening accounts in the name of the STCU Headquarters in Kyiv

In discussions with the GOU representatives, it has been communicated that the STCU may NOT open any accounts (local currency accounts or hard currency accounts) in the name of the STCU legal entity known as the STCU Headquarters in Kyiv. This is not an option.

2). Opening accounts in the name of the STCU Regional Office in Tashkent

a). **Local Currency (Tsum)** – According to discussions with the GOU representatives, the STCU Regional Office in Tashkent **CAN** open a Tsum account for “administrative needs” only. To be more specific, STCU Uzbekistan office administrative 'needs' includes payments in Tsum for renovation, stationery, phone, fax, etc. for the STCU Regional Office in Tashkent only.

However, according to discussions with the NBFAU and Asaka Bank, the STCU CANNOT utilize a Tsum account opened by the STCU Regional Office in Tashkent to make payments to vendors for equipment, materials, etc. for use by those institutes that are on STCU projects. In other words, if the STCU wanted to buy a computer using Tsum for ultimate use by an institute within an STCU project, this the STCU was told by the NBFAU, is not possible. This is considered commercial/business activity and not allowed, because as mentioned above the Tsum account can only be used by the STCU Regional Office in Tashkent for “administrative needs”.

b). **Hard Currency (USD and EUR)** – According to discussions with the NBFAU and Asaka bank, the STCU Regional Office in Tashkent **CAN** open a USD or Euro account, but the uses of this account are very limited. For example, a hard currency account opened by the STCU Regional Office in Tashkent may be used to send unspent “administrative need” money back to STCU Headquarter accounts back in New York, or to purchase items from vendors abroad for import for “administrative needs”.

However, according to discussions with the GOU representatives, the STCU Regional Office in Tashkent **CANNOT** utilize these hard currency accounts to make payments in hard currency to scientist's for grant payments or to institutes for overhead payments. These payments (to grantees and institutes) are not considered “administrative needs”, and thus these hard currency accounts opened by the STCU Regional Office in Tashkent **CANNOT** be utilized for these types of payments.

Important point – Opening accounts in the name of the STCU Regional Office in Tashkent either in Tsum or hard currency may not be the desired approach because of possible requirements for reporting to the GOU.

STCU's Proposed Solutions

The STCU proposes the following solution in order to remedy the differences between the STCU's banking requirements and the legislation of the Government of Uzbekistan. The STCU asks that the Central Bank of Uzbekistan issue the STCU Headquarters in Kyiv (not the Regional Information Office in Kyiv) with a license to do the following on the territory of Uzbekistan:

- 1). Open USD, EUR and Tsum accounts in Asaka Bank or the NBFAU.
- 2). Initiate payments from the STCU hard currency accounts mentioned in point 1). above, directly into the hard currency accounts of project grantees for grants and travel, and to institutes for overhead expenses.
- 3). Initiate payments to Uzbek vendors in Tsum for purchases of equipment, materials, etc. for use by the STCU Regional Office in Tashkent and STCU projects.
- 4). Maintaining the STCU's diplomatic privileges in Uzbekistan with regards to exemption from filing accounting reports to Uzbek government authorities.