Changes in the Uzbek banking system

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At the end of 2019, the new version of the Law of the Republic of Uzbekistan “On Banks and Banking Activities” (No. 216-I) (hereinafter the “Law”) was adopted. The new version of the Law provides for extensive and important changes which, in particular, include changes in the requirements for investors who want to purchase shares of local banks; strict obligations for commercial banks; as well as extended powers of the Central Bank of the Republic of Uzbekistan (hereinafter the “Central Bank”).

Acquisition of bank shares

According to the procedure which was in force before the adoption of the Law, in order to acquire 5 or more percent (but not more than 20 percent) in a bank, non-residents had to obtain prior permission from the Central Bank; now this requirement also applies to Uzbek residents. Unlike the previous procedure, the Law focuses on the ultimate beneficiary who will own the shares of the bank. Thus, under the new rules, individuals who are located, or legal entities whose ultimate beneficiary are registered, in a state with a preferential tax regime and/or which does not disclose the identity of the ultimate beneficial owner and provide information on financial transactions, cannot purchase bank shares. In addition, the Central Bank has the right to evaluate such a beneficiary; the procedure and conditions for such an evaluation are determined by the Central Bank. The Central Bank has the right to request additional documents or information to conduct such an evaluation; the applicant must provide such documents within 20 days or within 30 days with the permission of the Central Bank.

The Law restricts the ownership by foreigners, whereby the total share of non-residents – which are not international financial institutions, foreign banks and other credit organizations – should not exceed 50 percent of the bank’s charter capital. Thus, non-resident individuals do not have the right to purchase a stake of 50 or more percent of the bank’s charter capital.

Duties of the bank

One of the restrictions established by the Law is on the participation of banks in the charter capital of other legal entities (including other banks). Banks now do not have the right to create legal entities or participate in the charter capital of legal entities except for:

1. legal entities carrying out credit, insurance, and leasing operations on a professional basis;
2. legal entities that are a part of the financial market infrastructure or provide banks with information and consulting services;
3. legal entities engaged in professional activities in the securities market;
4. subsidiaries of the bank abroad, created to issue and place securities under bank guarantee;
5. legal entities, the exclusive activity of which is collection of money;
6. legal entities providing services for interaction between participants in settlements of banking operations, including settlements of operations with bank cards;
7. stock and currency markets;
8. credit bureaux;
9. joint-stock companies in the secondary securities market (up to a 20 percent stake in a listed company).

In addition, it should be noted that banks do not have the right to accept pledges in the form of shares of legal entities except for the abovementioned legal entities. Moreover, the share in the charter capital of such legal entities should not exceed 15 percent of the bank’s tier one regulatory capital. Banks’ transactions with securities, the acquisition of shares in the charter fund (charter capital) of legal entities shall not exceed 50 percent in total of the bank’s tier one regulatory capital. In case of exceeding such thresholds, the banks are obliged to sell the exceeding part within one year.

Banks are prohibited from participating in the charter fund (charter capital) of a legal entity that owns 1 or more percent of the charter capital of the bank. Banks are permitted to purchase shares of another bank or other securities held by another bank or shares in the charter funds (charter capital) of legal entities belonging to another bank while carrying out a reorganization process in the form of a merger or acquisition.

In contrast to the previous procedure, banks are now required to provide supervisory reporting together with financial statements. In addition, the Central Bank must be notified of any concluded agreement, the subject or content of which includes, among other things, the agreed exercise of the right to vote at general meetings of shareholders of the bank or general meetings of persons exercising control over the bank.

### Powers of the Central Bank

Earlier in 2019, the requirement to agree candidates for the chairman of a bank’s management board with the Central Bank was canceled. Under the new Law, such a requirement was re-established with additions. Now, not only candidates for members of the supervisory and management boards but also candidates for the so-called key personnel of the bank are subject to approval by the Central Bank. Key personnel are defined as non-members of the management board of a bank, whose positions allow them to have a significant impact on the activities of the bank. Evaluation conditions, documents required for evaluation, eligibility criteria, as well as the agreement procedure for members of the supervisory and management boards, as well as key personnel of the bank, are determined by the Central Bank. Besides, the Central Bank may demand the termination of the powers of each of the above persons.

The Central Bank will exercise prudential control over banks to ensure the financial stability of banks and protect the legitimate interests of depositors and creditors. Among other changes, banks can no longer distribute profits by paying dividends to shareholders, as well as remuneration to members of the supervisory and management boards, and employees of the bank in the following cases:

1. non-compliance of prudential standards with the requirements established by the Central Bank or their violation due to this distribution;
2. insolvency (bankruptcy) or signs of insolvency (bankruptcy) due to this distribution;
3. non-fulfillment or inability to eliminate the deficiencies identified by the Central Bank, which banks have a duty to address, including failures in information disclosure;
4. a request by the Central Bank on the non-distribution of profits;

Banks must also obtain permission from the Central Bank to distribute profits if:

1. distributed profit exceeds 10 percent of the bank’s capital;
2. there is a loss for the current or previous quarter and (or) for the financial year.

Banks are required to provide the Central Bank with the necessary information to assess their compliance with the prudential requirements of the legislation on banks and banking activities. The Central Bank inspects the systems, strategies, procedures and mechanisms used by banks to meet the requirements of the legislation on banks and
banking activities, and assesses the existing and potential risks of banks, including the risks presented by individual banks to the banking (financial) system. The frequency and extent of inspections and assessments are determined by the Central Bank without agreement and notification of state bodies and other organizations based on the principle of proportionality, as well as the systemic significance, specificity, scope and complexity of the bank activities.

In the following cases of:

1. non-compliance of the activities of a bank or a banking group with the requirements of the legislation on banks and banking activities;
2. a reasonable assessment of the Central Bank of a possible violation by a bank or a banking group of the requirements of the legislation on banks and banking activities over the next 12 months;
3. identification by the Central Bank of risks affecting the activities and (or) information security of a bank or a banking group;

the Central Bank can, among other things, require banks:

1. restrict and (or) prohibit the payment of additional capital, dividends and interest on subordinated debts to shareholders or holders of instruments, (including bondholders);
2. submit additional reports;
3. convene an extraordinary general meeting of shareholders from the bank’s supervisory board, a revision by shareholders of issues identified by the Central Bank, including the issue of increasing the bank’s capital to a size sufficient to ensure the financial stability of the bank;
4. terminate early the powers or replacing one or more members of the supervisory board, removing from office or replacing one or more members of the management board, as well as key personnel of the bank;
5. draft an action plan to restructure the debt of several or all creditors by the management board of the bank;
6. disclose additional information
7. perform other requirements of the Central Bank.

If the supervisory board of the bank does not convene an extraordinary general meeting of shareholders, the Central Bank may convene an extraordinary general meeting of shareholders and determine the agenda.

If the supervisory measures taken by the Central Bank on replacing one or more members of the supervisory or management boards of the bank are considered insufficient, the Central Bank has the right:

1. to temporarily work with the supervisory and management board of the bank;
2. to temporarily replace the members of the supervisory and management boards of the bank;
3. to appoint one or more temporary bank managers.

The Central Bank has an exclusive right to appoint and dismiss the temporary manager, to determine his powers per the charter of the bank and this Law.

The Central Bank has the right to apply measures and sanctions to the bank, members of the supervisory and management boards, as well as key personnel of the bank. Violations are divided into gross, serious and minor. For gross violations, the Central Bank may revoke licenses. Unlike the previous version of the Law, such grounds include:

1. not complying with the requirements of the Central Bank to eliminate gross violations in the activities of banks or banking groups on time;
2. preventing the Central Bank from performing its supervisory functions;
3. violating the rights and legitimate interests of consumers of banking services;
4. not disclosing information on ultimate beneficial owners;
5. breach of the Law by the members of the supervisory and management boards;
6. violating bank secrecy requirements.
Other developments

Under the Law the Central Bank has the right to identify a different procedure for obtaining preliminary approval when international financial institutions, foreign banks and other credit organizations with high capital and credit ratings seek to establish a bank or participate in the charter capital of a bank. The Central Bank, at its discretion, may facilitate or, conversely, complicate the process of establishing banks.

Banks are allowed to outsource banking services and operations – transferring certain types of services and operations on a contractual and ongoing basis to a third party, after obtaining permission from the Central Bank as per the requirements established by the Central Bank. Outsourcing certain types of services and operations carried out based on a license is allowed only to holders of the corresponding license. The procedure and conditions for obtaining such licenses are not defined by the Law.

The Law introduces the definition of a “systemically important bank” (a bank on which the stability of the banking system depends) and the definition of a “banking group” (an association of financial institutions, which is not a legal entity, in which the main bank controls other financial institutions). The Central Bank has the right to establish additional premiums for banks, banking groups and systemically important banks to the values of the liquidity ratios and capital adequacy ratios to cover potential losses arising from the maximum changes in risk factors inherent in the bank, systemically important bank or banking group.

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