

UK-UZBEKISTAN IFC WORKING GROUP REPORT:

Recommendations on developing
Tashkent International Financial Centre

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TheCityUK is the industry-led body representing UK-based financial and related professional services. In our 10th anniversary year, we continue to champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK, across Europe and internationally that drive competitiveness, support job creation and ensure long-term economic growth. The industry contributes over 10% of the UK's total economic output and employs 2.3 million people, with two thirds of these jobs outside London. It is the largest tax payer, the biggest exporting industry, generates a trade surplus almost equivalent to all other net exporting industries combined. It also makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and protect and manage risk.

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FOREWORD FROM THECITYUK

TheCityUK is the industry-led body that represents UK-based financial and related professional services. We promote policies that drive competitiveness, support job creation and ensure long-term economic growth.

In our international work, one of our priorities is to support the development of International Financial Centres (IFCs) in key developing and emerging markets.

London is one of the world's leading international financial centres and we believe that helping emerging financial centres develop can bring benefits to both the UK and its trading partners. IFCs provide a platform for investment into developing markets. They can also bring considerable benefits to their host markets by providing robust legal and regulatory frameworks, spurring market-driven reforms and boosting financial inclusion.

We have worked with a number of developing IFCs by providing a platform through which representatives of the UK-based financial and related professional services industry can share their expertise on developing a financial centre.

TheCityUK has been delighted to work with the Capital Markets Development Agency of Uzbekistan to convene a group of expert financial and related professional services practitioners in the UK and Uzbekistan to explore how Uzbekistan can develop its own IFC in Tashkent.

Uzbekistan is one of the world's oldest trading hubs: its ancient cities of Samarqand and Bukhara are justly renowned for their role as Silk Road hubs. Now that the country is embarking on an ambitious economic reform programme, there is an opportunity for Uzbekistan to develop its financial ecosystem so that it can resume its traditional role in global trade and benefit from the opportunities of the New Silk Road.

In this initial scoping report, we summarise the recommendations of our IFC working group on how authorities in Uzbekistan might go about developing an IFC. We hope these contributions can form the basis for a full stage feasibility study on the new proposed centre.

We look forward to working with our partners in Uzbekistan as this IFC concept develops.



Wayne Evans

Managing Director, International Trade and Investment, TheCityUK

MESSAGE FROM HER MAJESTY'S AMBASSADOR TO THE REPUBLIC OF UZBEKISTAN

The British government is proud to support the ambitious process of economic transformation on which the Government of Uzbekistan has embarked since 2017. Creating a more competitive, more dynamic and more open business environment, with less state involvement, has been at the heart of the reform process. No modern economy can truly flourish without the support and impetus of a vibrant financial services sector, driving competitiveness, supporting quality employment and ensuring robust business growth.

In this context, we are delighted to support the Capital Markets Development Agency in their work to strengthen capital markets in Uzbekistan, not least by creating an International Financial Centre in Tashkent. And we are equally delighted that TheCityUK, our flagship for UK-based financial and related professional services, has prepared this scoping report with expert recommendations on how to take the development of this project further. I believe that development of the International Financial Centre will be another stepping stone towards improving the business climate, strengthening the rule of law, and providing sustainable economic opportunities for all citizens across Uzbekistan. We look forward to continuing to work together to make a success of this great initiative.

Tim Torlot

Her Majesty's Ambassador to the Republic of Uzbekistan

MESSAGE FROM THE DIRECTOR OF UZBEKISTAN'S CAPITAL MARKETS DEVELOPMENT AGENCY

Developing efficient financial markets in Uzbekistan is our key priority, because without it, we will not be able to mobilise the required capital to grow our economy, create jobs and wealth for our citizens. Given our ongoing reforms, we have a unique opportunity to decide what type of financial market architecture and environment we want to build in Uzbekistan.

Thanks to the support from the British Embassy in Uzbekistan and assistance of TheCityUK, we have produced a preliminary but professional report on the possibility of creating a financial market environment in our capital city of Tashkent, by incorporating international best practices and regulatory standards.

We are pleased to share this report with the public, and hope this will be the start of a wider discussion with key stakeholders, as we prepare for a more detailed and comprehensive feasibility study.

Atabek Nazirov

Director, The Capital Markets Development Agency of the Republic of Uzbekistan

INTRODUCTION

Uzbekistan's government has embarked on an ambitious economic reform programme to raise standards of living in the country.

There are many aspects to this reform programme but developing a strong financial and professional services ecosystem in Uzbekistan is a critical priority. In order for the country to move forward, its businesses need enhanced access to capital; and for that, there is a need to develop capital markets and broaden the country's financial base.

Policymakers are exploring ways of developing Uzbekistan's financial ecosystem. One option is for Uzbekistan to develop Tashkent International Financial Centre (TIFC) to provide a platform for international investment in Uzbekistan and to encourage the development of Uzbekistan's capital markets.

The Capital Markets Development Agency (CMDA) asked TheCityUK's UK-Uzbekistan IFC Working Group to provide some initial advice on what TIFC might look like. The CMDA explained that it thought TIFC might serve the following goals:

- form a bridge between foreign investors and domestic businesses
- facilitate the access of foreign capital into the local market
- develop flexible and internationally recognised legal standards
- transfer knowledge through engagement with the international community
- improve the availability of funds for investment in the Uzbek economy
- extend instruments for local business
- increase liquidity in the local capital market
- facilitate the development of disputes under English common law.

The CMDA asked the group for guidance on which considerations it should have in mind when putting together a full scoping study to assess the feasibility of an IFC along the lines of the model described above.

The group's assessment was that an IFC could provide significant value to Uzbekistan. It could serve as a catalyst for broad based economic growth both by being a source of employment and activity itself but also by encouraging international and domestic investment into Uzbek businesses. It could also provide the Uzbek government with a channel through which to pursue the privatisation of state-owned enterprises (SOEs). The group noted that TIFC would only work if it secured support from a range of government, regulators and business stakeholders. It provided a series of suggestions which can be found in this report.

HOW SHOULD TIFC CREATE A GENUINE FINANCIAL AND RELATED PROFESSIONAL SERVICES ECOSYSTEM?

TheCityUK has produced a range of research on IFCs. In 2017, TheCityUK and PwC launched 'A vision for a transformed, world-leading industry' that identified which factors and indices are most important to measure when seeking to determine a country's rank as an IFC.¹ The report also identified steps public and private sector decision makers in the UK should take to ensure the country's continued global pre-eminence.

At the core of the report is the understanding that an IFC has to be viewed as an ecosystem. When looking at what makes an attractive centre, a range of quantitative and qualitative factors need to be considered. Infrastructure or urban planning cannot be seen in isolation; important dynamics include whether the financial centre has strong financial and regulatory infrastructure and a network of related professional services firms that can support it. Other relevant factors behind London's status as an IFC include:

- access to UK, European and International Markets
- there is a 'cluster effect' of a full ecosystem, including the co-location of finance, business, technology and government
- the UK provides deep pools of capital and liquidity and strong risk management
- UK firms have access to highly skilled talent pools
- the UK offers an attractive lifestyle
- international use of English law and language are key strengths
- the UK has high-quality regulators, with a strong regulatory regime.

None of these factors are responsible for the UK's success as an IFC by themselves; however, together they help explain it. IFCs benefit from a cluster effect: firms across the industry learn from each other, strengthen each other's offerings and form new partnerships.

A critical challenge for TIFC will be to find ways of creating a financial and professional ecosystem. This can be achieved: Dubai International Financial Centre (DIFC), for example, created a financial and related professional services ecosystem virtually from scratch between 2002 and 2009. However, the task is a challenging one.

The group suggested that the report consider the following areas:

- To help develop an ecosystem, an IFC needs to refine an attractive offer for a range of highly skilled international financial and related professional services professionals to base themselves in the new centre and help develop its infrastructure and business environment. Professionals in TIFC must be able to benefit from proximity to good schools, hospitals, transport links and cultural activities. A scoping study should therefore reflect on what Tashkent IFC's proposition to attract international practitioners should be. Different IFCs produce different propositions: Abu Dhabi's IFC has positioned itself as an attractive destination for families, whereas Dubai IFC appeals more to younger workers.
- How can city authorities and government departments work together to create and finance the construction of the infrastructure (e.g. offices, IT, houses, cultural activities) that will help attract international talent? How can Tashkent form partnerships with international schools so that they can set up campuses in Tashkent?
- What should the visa and residency requirements be for international workers coming to TIFC?
- Is physical infrastructure needed in TIFC apart from the office facilities required for IFC administration? Would TIFC property be owned or built by the IFC/other State entities or private real estate companies? And should there be preferential rental/tax arrangements for financial services and other businesses who base themselves in the IFC site?

¹ TheCityUK, 'A vision for a transformed, world-leading industry', (July 2017), available at: <https://www.thecityuk.com/research/a-vision-for-a-transformed-world-leading-industry>

- Should TIFC follow an enclave approach to ecosystem development whereby authorities seek to co-locate all financial and professional services functions in the same district of the city? This is the model pursued by the financial centre in Dublin: having everyone involved in the IFC working side by side can help to create a feeling of community and strengthens the sense of an ecosystem. It also allows IFC regulators to have ready oversight of businesses in the centre.
- Should TIFC follow a club approach to an IFC? Under this model, businesses within a much broader defined space (for example, the city of Tashkent) have the option to register to be treated as members of the IFC whether or not they are located close to the IFC authorities and regulators. Astana International Financial Centre (AIFC) offers an example of this. Any business within a large area of Nur-Sultan can register to become an AIFC member, whether based in the AIFC's physical location or not.
- When considering these choices, the scoping study should be clear that TIFC must not become seen as being principally a real estate project. Soft infrastructure (e.g. establishing a legal and regulatory regime) is more important than the hard infrastructure that supports the centre.

WHAT LEGAL AND REGULATORY STRUCTURE SHOULD TIFC ADOPT?

IFCs follow different models in terms of their legal and regulatory structure. One model, pioneered in DIFC and adopted in AIFC, is for the IFC to have an entirely different legal and regulatory order than its host country.

An alternative model would be to have the financial centre using the same (or substantially the same) legal and regulatory system as the rest of Uzbekistan.

The group considered which model might work best in TIFC and suggested that the following ideas be explored in a feasibility study:

- In previous cases where an IFC became a separate jurisdiction, the host country's constitution had to be changed. Would a constitutional change be required in Uzbekistan to create TIFC? What steps would need to be taken to ensure this could happen?
- What are the pros and cons of both approaches to an IFC? One reason for creating a separate legal and regulatory structure based on international norms is that it will give the IFC more credibility in the eyes of investors and international financial businesses. One reason for having an IFC operate under the Uzbek legal and regulatory regime is that it could lead to a stronger relationship between the IFC and the rest of Uzbekistan. In any event, the relationship between the IFC legal and regulatory structure and that of Uzbekistan will be very important – including in relation to the conduct of authorised/regulated activities and enforcement of judgments.
- Whatever regulatory structure is adopted, the study should be clear that the TIFC needs to be able to attract international investors and financial businesses. Likewise, TIFC's long term sustainability will depend, in part, on TIFC authorities being able to work well with Uzbekistan's regulators and authorities.
- The study should address whether TIFC authorisation should cover activities in the whole of Uzbekistan.
- The feasibility study should consider what steps TIFC could take to help it become seen as an exemplar in the region for good governance and regulatory practice. What kind of laws and regulations should it frame in order to attract companies from other countries in central Asia to the IFC?
- When considering how to benefit from the advantages of English common law, the feasibility study should review how TIFC could work with the already existing legal system in AIFC. Should TIFC seek to develop its own court and dispute resolution centre? Or would there be value in exploring partnerships with the AIFC's court and dispute resolution system? When assessing these options, the study should consider the following:
 - The TIFC's legal system is likely to include at least three aspects: a regulatory system; a system of contract (and possibly tort) law; and a dispute resolution system. Each will need to be considered separately.
 - A top priority for TIFC is to provide businesses and investors involved with the centre with the confidence that, should a dispute or legal matter arise, they will have ready access to a high quality, independent legal system presided over by expert common law judges.
 - If Tashkent IFC makes use of AIFC's legal system, TIFC regulators would be subject to decisions made in AIFC courts. Is this something that TIFC stakeholders could accept?
 - Could a hybrid approach be adopted, whereby some legal cases are tried in TIFC and others in AIFC?
- Is there a need for TIFC to develop a separate body of contract and tort law as part of the initial IFC development phase?
- When considering regulatory issues, the report should provide suggestions on:
 - Which kinds of financial activities should be established at the IFC (these could be expanded over time)?
 - Which financial activities will require authorisation, and ongoing regulatory supervision, by the IFC regulator?
 - Is there a need for a regime for incorporation and establishment of entities as part of the IFC regime?
 - What types of entity need to be covered: public and private companies, limited partnerships, LLPs and funds?
 - Should the centre instead be open to anyone who wishes to apply for registration?
- Training for local professionals in relation to the TIFC rules and regulations will be essential as their buy-in to the concept will be important.

WHAT APPROACH SHOULD TIFC TAKE TO TAXATION?

The CMDA explained that it is working on the assumption that TIFC will be a tax neutral destination for investors: that is, for example, a group which establishes a holding company and/or treasury company in the TIFC to raise funds from investors to be invested in business opportunities in Uzbekistan will be subject to normal tax on the profits they make in Uzbekistan but could not be subject to any further tax in paying dividends and interest up to the TIFC holding company, which itself would not be subject to further taxation. There could potentially be favourable tax treatment for dividends and capital gains on TIFC-listed securities.

The group discussed alternative tax models that could be pursued in an IFC: an offshore model, whereby businesses that invest in Uzbekistan through TIFC pay less tax on profits from Uzbekistan than they otherwise would; or a double tax model, whereby businesses pay Uzbek tax and TIFC tax. The group advised that a tax neutral structure appeared preferable in principle, although a feasibility study should review the options in more detail.

Businesses carrying on financial services activities in the TIFC could be subject to favourable tax treatment.

The group accordingly made the following suggestions for what the feasibility study should consider:

- Should TIFC tax concessions be open only to financial businesses or should it also be open to non-financial businesses (in effect becoming a wider scope tax free economic zone)? This could have significant tax implications for Uzbekistan and help determine the character of TIFC.
- If non-financial sector holding companies or treasury companies can establish within TIFC, thought needs to be given to their tax levels. For example, would a cotton company based in TIFC but carrying on business in Uzbekistan pay double tax – i.e. a tax in the centre and then standard Uzbekistan tax rates? Or only a low level of tax in TIFC and no tax in Uzbekistan? Or the same amount of tax as a normal business in Uzbekistan?
- If a tax neutral approach is to be adopted, the study should review the overall competitiveness of taxes in Uzbekistan. Would simplifying the tax code help encourage more foreign investment into the country?
- Should there be tax concessions for businesses that seek to base themselves in Tashkent IFC (whether participants, listed companies, or IFC incorporated entities)?

WHAT SHOULD TIFC'S UNIQUE SELLING POINTS BE?

IFCs are not identical; each centre benefits from particular strengths which often stem from a centre's history or geography. For example, London became the capital of international insurance in part because of a specialisation in maritime reinsurance. More recently, Dubai IFC has become known for Islamic Finance.

The TIFC feasibility study should consider how Uzbekistan can build on its traditional strengths and develop its own USP. The study should consider Uzbekistan's history as a trading centre, having been at the centre of Eurasian trading routes for millennia and today is located next to some of the world's richest natural resources reserves and food sources. How can Uzbekistan build on this legacy to develop a contemporary proposition?

The group made the following suggestions:

- The study should explore how TIFC could position itself in global commodities trade and become a regional centre of excellence for trade finance. While many of the world's resources are located in central Asia, there is no major trading centre between Hong Kong and Europe. This introduces inefficiencies in commodities trading: products from the region need to be traded in different time zones. Although many financial centres have sought to become centres of trading in derivatives and complex financial products, few have thought of developing more niche commodities markets that cover basic products like gold or rice. An IFC in Uzbekistan could help plug this gap in global markets coverage.
- Should TIFC develop additional financial markets beyond commodities? Which markets should these be? Possible options include: a main market, an SME market, a natural resources market, debt markets and fund markets.
- Should there be a new TIFC Stock Exchange? Or should TIFC authorities help develop Uzbekistan's existing stock exchange?
- If there is to be a new TIFC market, which entity is to have responsibility for preparation and enforcement of listing and other market rules? What securities can be listed –shares? Bonds (with or without conversion)?
- The feasibility study should also consider Uzbekistan's potential to develop as an Islamic Finance hub. Although Uzbekistan does not yet have a well-established Sharia market, Uzbek Sharia scholars in financial services have exported well into other core markets such as the Gulf Region and South East Asia. The Islamic Development Bank is working with the CMDA and the Uzbek government to build on this solid base and to strengthen Shariah compliant finance in Uzbekistan. When assessing how an IFC could support Islamic Finance, the study should consider that it is important to make sure that the fundamentals for an Islamic marketplace are firmly in place, especially in terms of establishing the domestic market infrastructure for Islamic Finance.

WHAT ROLE SHOULD FINTECH PLAY IN TIFC?

FinTech (technology used to support or enable financial services) is changing the requirements for IFCs. If TIFC were to attempt to develop a specialism in commodities trading, it would now need to be able to provide investors with market infrastructure technologies and automated systems which are in advance of what is offered in leading financial centres. The centre would also need to provide banks and financial institutions with speedy and reliable AML/KYC processes.

The group recommended that a feasibility study should:

- Give thought to the kinds of technologies that TIFC would need to succeed and the level of investment and the kinds of partnerships that would be necessary to ensure these technologies are available.
- Consider how FinTech solutions could help Uzbek financial institutions modernise their processes and hence become more effective stewards of capital within Uzbekistan.
- Review how FinTech solutions are changing the way trade finance products are being offered and consider whether TIFC could make use of these new tools.

HOW CAN UZBEKISTAN'S AUTHORITIES DEVELOP THE TALENT TO MAKE TIFC WORK?

IFCs can take different approaches to talent development. In many IFCs, there is a strong reliance on international professionals. Other IFCs have worked hard to develop a pipeline of domestic talent.

The group suggested that given Uzbekistan's young and growing population (the country has more millennials than any other in central Asia), it made sense for authorities designing an IFC to seek to upskill domestic talent so that TIFC could be driven by Uzbek workers.

The group suggested that a feasibility study should:

- Consider how the Uzbekistan Ministry of Education could work with IFC authorities to develop a future talent pipeline. Education reforms take time: it could be ten years before they deliver significant results. Thought should be given to how to integrate the timelines of IFC development and education reforms.
- Make suggestions on how Uzbekistan's education system might be tailored to ensure that it creates the right skillsets for financial and professional services practitioners. Students need to be trained in critical thinking and problem solving.
- If English law is adopted within TIFC, a feasibility study should consider how authorities can best train lawyers, potential new lawyers and industry practitioners in English law.
- Consider the merits of TIFC creating a dedicated bureau for Continuing Professional Development (CPD). The AIFC's CPD Bureau provides a one stop shop for training and education efforts in the centre; this might be a model to consider.
- Recognise Uzbekistan's considerable efforts to engage with international educational institutions (for example, Westminster International University in Tashkent is the first university in Central Asia to offer courses with UK qualifications) and suggest ways in which authorities could build on these initial steps.
- Consider the potential for the British Council to assist with skills development in Uzbekistan, not least through English language courses.

CONCLUSION AND NEXT STEPS

The government of Uzbekistan has embarked on an ambitious programme of economic reforms. A range of positive economic indicators testifies to the initial success of these efforts.

Developing an IFC could form a critical pillar of the next stage of the reform programme. It could help the country develop stronger capital markets, boost FDI and deepen its integration into the international financial system.

This decision may bring many challenges and it will require government departments, regulators and businesses to work closely together around a common vision of the country's future and for the TIFC.

However, the prize of increased economic growth and stronger ties to international markets should make this task worth persevering at despite these difficulties.

The group's recommendations cover some critical aspects of IFC development. They are not comprehensive but should provide a starting point for a full stage feasibility study for TIFC.

The group recommends that these observations are used to provide the basis for the Terms of Reference for the feasibility study into establishing TIFC.

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We would also like to thank working group members for giving their time and expertise and helping formulate the recommendations found in this report.

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