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Kazakhstan: Boosting Access and Development

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Asian Development Bank

CURRENCY EQUIVALENTS
(as of 4 September 2013)

Currency Unit	–	Tenge (t)
T1.00	=	$0.0065
$1.00	=	T153.52

ABBREVIATIONS

ADB	–	Asian Development Bank
AMFOK	–	Association of Microfinance Organizations of Kazakhstan
CPF	–	Central Provident Fund
DAMU	–	DAMU Small Entrepreneurship Development Fund
EBRD	–	European Bank for Reconstruction and Development
FIAK	–	Financial Institutions' Associations of Kazakhstan
FSC	–	Financial Supervision Committee
GDP	–	gross domestic product
GMRA	–	Global Master Repurchase Agreement
HCSB	–	Housing Construction Savings Bank
IAIS	–	International Association of Insurance Supervisors
IFC	–	International Finance Corporation
IFRS	–	International Financial Reporting Standards
IMF	–	International Monetary Fund
IPO	–	initial public offering
JERP	–	Joint Economic Research Program
JICA	–	Japan International Cooperation Agency
KASE	–	Kazakhstan Stock Exchange
KMC	–	Kazakhstan Mortgage Corporation
MAOKAM	–	Government Medium-term Special Treasury Obligations
MEKKAM	–	Government Short-term Treasury Obligations
MEOKAM	–	Government Medium-term Treasury Obligations
MEUJKAM	–	Government Long-term Savings Treasury Obligations
MEUKAM	–	Government Long-term Treasury Obligations
MTM	–	market-to-market
NBK	–	National Bank of Kazakhstan
OTC	–	over-the-counter
PAIMO	–	Pension Assets Investment Management Organisation
PRC	–	People's Republic of China
S$	–	Singapore Dollar
SGS	–	Singapore Government Securities
TONIA	–	Tenge Overnight Index Average
UNDP	–	United Nations Development Programme
USAID	–	United States Agency for International Development

NOTES

(i) The fiscal year of the government and its agencies ends on 31 December.
(ii) In this report, "$" refers to US dollars unless otherwise stated.

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EXECUTIVE SUMMARY

The over-rapid expansion of lending and subsequent adverse effects of the global financial crisis left banks in Kazakhstan with large amounts of overdue loans and less able to refinance their loan portfolios. It also left many businesses and households with debts they were unable to repay or service. The values of securities provided against loans depreciated and became inadequate for full recovery of the debt. Nonperforming loans rose from about 3.0% before the global economic and financial crisis of 2008 to 35.9% at end of 2011. Loan portfolio quality improved only marginally in the two years mid-2011, and a rapid increase in overdue interest income has further undermined quality. The requirement that banks pay tax on loan write-offs, leading them to show bad debt in their balance sheets rather than following a program of loan write-offs, compounded the problem. While the banking sector is characterized by poor earnings and a restructuring of three large banks in aggregate, some banks are taking advantage of market conditions to expand market share and have satisfactory levels of earnings. Banks also appear to be learning from their recent experience and are incorporating better management practices into operations.

The tax code used to treat loan write-offs and associated loss provisions as taxable income, encouraging banks to keep bad loans on their books. The Amendment to the Tax Code, valid only during 2012, allowed banks to write-off bad loans without incurring income tax. Consideration could be given to make this amendment permanent (or should be extended until the banks clear their balance sheets). An outstanding concern is that the forgiveness of debt should be treated as taxable income in the hands of the debtor.

The National Bank of Kazakhstan (NBK), the central bank, require all banks to comply with Basel III and International Financial Reporting Standards 9 requirements from 1 January 2013. The central bank is receiving hands-on advice and assistance in bank supervision. Ensuring full compliance may cause financial asset values to decline, however, and result in a need for many banks to add capital to their businesses.

The Law on Risk Minimization, which came into effect in February 2012, is intended to provide greater transparency in shareholder structures in the finance and corporate sectors, more information on the sources and uses of earnings, and lead to more stringent regulation of related-party lending. This should improve investor confidence in firms and lead to more efficient and better allocation of investor and lender funds.

Most business and debt restructuring has been in larger firms. In the 2008–2012 time period, lending to small enterprises declined, while the business failure among small firms is 10 times that of large businesses. Because small firms are able to respond quickly to changes in the economic climate and are substantial employers, this attrition rate is a concern. Strengthened bank staff capacity evaluating and restructuring small businesses in difficulty could help further develop the small business sector. The rehabilitation of businesses, especially small businesses, could be reviewed against recent amendments to the Law on Bankruptcy to determine where procedures related to the law could be streamlined to expedite business and debt recovery.

While most banks provide internet banking services, uptake has been minimal, with banks focusing more on cleaning up their loan portfolios. There has been widespread expansion, however, in the use of payment cards through ATMs and point-of-sale outlets. One bank in particular plans to expand the range of products available through electronic banking and is fully aware of the opportunities in financial service products and the success of electronic banking in other countries. Another nonbank financial institution will implement electronic banking for a

limited range of financial products, such as municipal tax payments, in addition to pension payments. These institutions are expected to acquire proprietary value through their own efforts.

Microfinance services are developing through bank partnerships with mobile network operators, which will allow for microcredit disbursements and repayments, deposit services, access to cash through point-of-sale outlets and ATMs, money transfers, and better access to microinsurance products such as accident and health insurance. Microinsurance is included as a service that microfinance organizations, as agents for insurance firms, can provide under the new law on microfinance organizations. The law on microfinance organizations, approved in November 2012, does not allow microfinance organizations to take deposits, making it difficult for them to compete with banks in the provision of a broader range of electronic banking services.[1] Furthermore, the need for microfinance organizations to finance asset growth only out of borrowing additional equity and retained earnings will constrain their lending outreach.

Kazakhstan is the largest insurance market in Central Asia and is ranked 68th in the world on premium ranking (0.03% of world market share). The nonlife insurance segment dominates the insurance sector, with about 78% market share. The gross written premium in 2012 reached 0.6% of gross domestic product (GDP) ($1.57 billion), of which voluntary insurance accounted for 75% of GDP and compulsory for 25% of GDP. Of the gross written premium, voluntary nonlife insurance purchases contribute 52% and compulsory insurance 26%. By comparison, life insurance in Kazakhstan is still at a nascent stage, and nearly 71.4% of the life portfolio in 2012 was comprised of annuities. The three largest insurance companies held 40.6% of subsector assets in 2011. The insurance market in 2013 is expected to maintain the trends of 2012 amid favorable economic conditions and steady oil prices. Potentially negative factors in the sector would include a downward trend in underwriting performance, deterioration in risk-adjusted capitalization and the credit quality of investments, a sustained increase in credit risk exposure associated with reinsurance placements, and a decline in country risk fundamentals.

Rapid economic growth, high inflation, and underdeveloped financial markets tend to expose both insurers and supervisors to challenging decisions. Insurance supervision has aimed principally to authorize new companies that can be relied on to maintain solvency, and to establish monitoring systems that assure continuing reserve adequacy. The need for an effective supervisory structure is evident because the regulatory regime is often changing as different approaches to insurance regulation are adopted over time, although most of the regulations are modeled on European Union directives. Beyond considering the impact of reinsurance on the solvency of domestic companies, reinsurance regulation has not received much attention. This is partly due to the absence of a reinsurance regulatory model in Europe, on which much of the insurance regulations in Kazakhstan are based. Reinsurance placements with low credit quality institutions and outstanding claims recoverable from reinsurers with vulnerable or unknown ratings contributed to the adverse conditions the insurance industry was exposed to. In May 2012, new reinsurance rules were introduced under which insurers will cede up to 75% of risk to a domestic reinsurer and rating requirements for foreign reinsurers were increased. Moreover, the supervisor has doubts about the adequacy of technical knowledge or resources to monitor ceding companies' transactions.

Legislators are drafting a new law on compulsory insurance to deal with natural and manmade disaster aimed at people and their property and will define disaster-risk financing options for protection in the aftermath of disasters.

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[1] Law of the Republic of Kazakhstan dated November 26, 2012 № 56-V «On Microfinance Organizations. http://kazakhstanlawfirm.com/post/37696347128/law-of-the-republic-of-kazakhstan-on-microfinance#sthash.3DSX2ybr.dpuf

Because of limited access to capital market instruments, insurers have relied heavily on investments in Kazakhstan's banking and corporate sectors (and in some cases in low credit quality institutions). This exposes them to the country's high financial system risk. Knowledge is lacking of the pricing of insurance products and the design of benefits tailored to the needs of customers, as well as of the use of alternate distribution channels like bancassurance, mobile technology, and others. At the same time, an onerous claims procedure in no way helps propagate an insurance culture.

The emergence and rapid growth of the debt securities market in Kazakhstan is attributed largely to an initiative sponsored by the United States Agency for International Development that focused on their development rather than on equities. The NBK's promotion of the development of private pension funds, creating domestic institutional money to invest in fixed income and the professional money managers to invest it, is also credited. Kazakhstan's securities market suffered the impact of the global financial crisis by the middle of 2008, continuing into 2009 as the devaluation of the tenge in February 2009 exacerbated the impact. The crisis helped set up a "market squeeze," saw bond spreads widen, cut trading volumes, and narrowed the list of traded instruments, and increased borrowing costs and refinancing risks. Stress in the finance sector in 2009–2010 was associated with the default of more than 50 corporate bond issues from more than 30 issuers.[2] Defaults declined significantly in 2010, but the corporate bond market has yet to regain its pre-crisis position, with state and state-owned entities dominating issuance in the securities market.

Government established a mandatory, employee-funded defined contribution pension system in January 1998, after passing legislation in 1997. While reform of the demand side is critical to development of the capital market, the securities market is still unable to fully absorb assets under management that the reforms generated. The limited supply of securities has created a demand-supply imbalance that hinders the ability of the accumulated pension funds—tasked with managing the assets—to do so. A strategic debt management program, one result of which would be structured benchmark issuance, has not yet been implemented. Regular, strategic government bond issuance would support the evolution of a benchmark yield curve that would provide market participants a pricing reference for issuance of other fixed-income products, such as corporate bonds, asset-backed securities, and infrastructure bonds. A benchmark yield curve is also essential for asset managers to calculate the mark-to-market value of portfolios. At the same time, pension fund managers' investment decisions are constrained by prudential guidelines rather than by the need to maintain a commensurate risk profile, in the process, focusing on diversification, duration, and denomination. Kazakhstan's private pension funds are in the process of unification under state ownership and NBK management and the transition is not without risks. This move is expected to increase the participation of banks and nonbank financial institutions in the market for government paper, as demand for such paper from pension funds declines, could provide support to the NBK's move to more active open market operations.

Improving the disclosure of information, the improvement of the business environment, and the improvement of the outreach of microfinance services will help develop the banking sector and the microfinance services subsector.

To help improve disclosure of information in financial institutions, technical assistance could contribute to (i) enhanced governance and financial reporting, (ii) improved procedures and

2 Three second-tier banks—BTA Bank, Temirbank, and Alliance Bank—all had negative net worth by late 2008 and stopped servicing their debts in the first half of 2009.

reporting formats for the accounting and analysis of intercompany transactions, and (ii) up-to-date training and training materials for regulators.

To support the development of the business environment and encourage entrepreneurship while protecting creditors, technical assistance would include advising the government on the procedures and legislation for debt resolution and delivering up-to-date training for regulators, DAMU, and financial institutions in the debt analysis and restructuring of small and medium enterprises.

To support the development of microfinance organizations, technical assistance could help establish cost-effective supervision and monitoring of microfinance organizations and develop a plan to allow larger and better-performing microfinance organizations to eventually become deposit taking financial institutions. Technical assistance could also assess the role of credit partnerships in microfinance and recommend ways to improve their monitoring and supervision. Only limited information is now available on the performance of credit partnerships. Such technical assistance would take into account the results of the small and medium enterprise survey now under way (the ADB technical assistance Improving Capacity to Support SME Development), and recommend ways to improve the access of rural households and enterprises (including women) to financial services.

To support the development of the insurance market, technical assistance could help enhance regulation and supervision of the insurance market and, in turn, transparency, efficiency, and coverage. The population could then be expected to use better-designed insurance products to manage the risks in their lives and assets, and public perception and confidence in insurance would improve. The proposed technical assistance would include the following support:

(i) assess the insurance sector against the International Association of Insurance Supervisors (IAIS) insurance core principles and standards and identify weaknesses and opportunities in consultation with the insurance companies and intermediaries and stakeholders (such as ombudsman);
(ii) establish an effective supervisory structure that is capable of linking off-site and on-site monitoring;
(iii) develop a robust analytical and reporting framework that assists in risk management (including management of assets and liabilities and reinsurance) and assures continuous risk-based solvency of insurers at all times;
(iv) help insurance industry participants define the contours of better-designed products and alternative distribution channels and to share in the experiences of other countries; and
(v) upgrade the professional skills and expertise of supervisors, regulators, industry participants, and local professionals by raising awareness of risks and their estimation and management for increased transparency.

To support the development of the securities market, technical assistance could help strengthen the nonbank finance sector to underpin domestic savings and support economic growth. The desired outcome would be a deeper, more diversified nonbank finance sector and expansion of the finance sector to support economic growth. The technical assistance would develop (i) policy and consensus building, (ii) a primary market for government securities, (iii) a secondary market for government securities, and (iv) a corporate bond market.

To understand the major constraints in developing Kazakhstan's securities market, interventions could be considered at both regional and country levels. Regional technical assistance could

help build capacity through training programs. Consideration could be given to the introduction of a regional credit rating agency funded by international financial institutions and local and regional stakeholders (private as well as public). Country assistance programs could build capacity in the Committee for the Control and Supervision of Financial Market and Financial Organizations of the National Bank of the Republic of Kazakhstan to facilitate a move to a full disclosure approval process (known as the Financial Supervision Committee [FSC]). They could support the development and reform of the institutional investor base, including life insurance companies as well as pension funds. And they could engage a resident expert to work with Ministry of Finance officials for 2–3 years to develop debt management strategy and a benchmark issuance program.

I. Introduction

1. The Financial Sector: An Overview

A. Macroeconomic Development

2. Kazakhstan has large fossil fuel reserves and supplies of other minerals and metals. It is the largest of the former Soviet republics, excluding the Russian Federation, and, in 2000, became the first to repay its debt in full to the International Monetary Fund (IMF), 7 years ahead of schedule. In 2002, it was also first to receive an investment-grade credit rating. During 2000–2007, Kazakhstan's economy grew more than 9% a year, driven by the extractive industries, particularly hydrocarbons and mining.

Table 1: Growth and Price Indicators

	2008	2009	2010	2011	2012
Real gross domestic product (% change)	3.3	1.2	7.3	7.5	5.0
Consumer prices (average, % change)	17.0	7.3	7.1	8.3	5.1

Source: Asian Development Bank (ADB). 2013. *Asian Development Outlook 2013: Asia's Energy Challenge.* Manila: ADB.

3. Gross domestic product (GDP) growth slowed sharply to 3.3% in 2008 and 1.2% in 2009 amid the global financial crisis, from 8.9% in 2007. It recovered quickly to 7.5% in 2011 helped by higher oil prices and greater public expenditure. However, declines in oil and agricultural output lead to GDP growth slowing to 5% in 2012. GDP per capita reached $12,006 in 2012, from $3,790 in 2005. The population in 2012 was estimated at 16.9 million people, with nearly 55% in urban areas. The rich, modern, and fast-growing major cities contrast with the sparsely populated and much less developed rural areas. The poverty headcount rate declined from 46.7% in 2001 to 5.3% in 2011, yet the gap between urban and rural living standards remains—it is under 4% in urban areas and about 10% in rural. The unemployment rate was a relatively low 5.3% in 2012, down from 6.3% in 2009.

4. In economic sectors, agriculture plays a relatively small role in the economy compared with other Commonwealth of Independent States countries, accounting for 5.2% in 2011. Industry accounted for 38.9% and services 59.9%.[1] The European Bank for Reconstruction and Development (EBRD) estimates the private sector share of GDP at 65.9% for 2012.[2]

5. Helped by moderating food prices, headline inflation stood at 6.0% at end-2012, down from 7.5% at end-2011

6. The official refinancing rate remained at 7.0% throughout 2010, rising to 7.5% in March 2011, but falling to 5.5% in June 2012, the lowest level ever due to a decline in inflation that reduced banks' funding costs. However, it is expected that this reduction will not have material impact on the growth of lending to the economy. The rate on deposits attracted from banks is currently 0.5% on 7-day deposits and 1.0% on 1-month deposits.

7. The currency of Kazakhstan is the tenge, which was introduced in November 1993. The exchange rate is determined on the basis of foreign exchange auctions that are held on a daily

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[1] Central Intelligence Agency (CIA). 2013. *The World Fact Book*. CIA: Washington, DC.

[2] EBRD. 2013. Regional Economic Prospects in EBRD Countries of Operations: May. EBRD Office of the Chief Economist. EBRD: London. http://www.ebrd.com/downloads/research/transition/tr10.pdf.

basis. Auctions are held for U.S. dollars, euros, and Russian rubles, and official rates are quoted for over 30 other currencies on the basis of cross-rates. In February 2009 the tenge was devalued by 18% against the US dollar, and a trading band of T150/US$ +/- 3% was established. In February 2010, the trading band was widened and set at an asymmetric T150/US$ +10/-15%. In February 2011, the trading band was officially abolished, and the de jure exchange rate arrangement was changed from a pegged exchange rate within horizontal bands to a managed float.

8. Kazakhstan faces a number of strategic challenges. The global economic and financial crisis highlighted its excessive dependence on primary industries and commodity exports and the need, therefore, to diversify the economy towards value-added industries. It is also important to reform the finance sector and ensure that it emerges from the crisis with a sustainable business and funding model. Remaining transition gaps in the country's infrastructure, including shortages and imbalances in power and energy, and transport bottlenecks, also need to be filled.

B. Fiscal Sustainability

9. High commodity prices provide the basis for low public deficit and public debt levels, both on an annual and accumulated level (Table 2).

Table 2: Government Fiscal Accounts and External Accounts (% of GDP)

	2008	2009	2010	2011	2012
Current account balance	4.7	-3.6	0.9	6.5	3.8
Overall fiscal balance	1.1	-1.4	1.4	5.9	-4.5
Public external debt, including guaranteed	1.2	2,8	3,2	2,7	2,7
Total external debt	79.8	97.9	79.9	66.6	67.6

GDP = gross domestic product.

Source: Asian Development Bank (ADB). 2013. *Asian Development Outlook 2013: Asia's Energy Challenge.* Manila: ADB; International Monetary Fund. 2013. *Republic of Kazakhstan: 2013 Article IV Consultation—Staff Report; Supplement; and Public Information Notice*. Washington, DC. http://www.imf.org/external/pubs/cat/longres.aspx?sk=26041.0
National Bank of the Republic of Kazakhstan (NBK). 2012. "2011 Annual Report." NBK, http://www.nationalbank.kz/cont/publish824801_10380.pdf.

C. Business Environment: Access to Financial Services

10. Of the 144 countries assessed in The World Economic Forum Competitiveness Report, Kazakhstan ranked 51 for overall competitiveness, and considerably lower, at 115, in financial market development.[3] For financial market development sub-pillars, Kazakhstan ranked higher for all indicators, with the exception of soundness of banks, at 120. For ease of access to loans it ranked 110. While the quality of education of the workforce was ranked the most problematic factor, corruption, tax regulations, and access to financing were ranked 2nd, 3rd and 4th most problematic, respectively. Given the apparent lack of access to finance, it is reasonable to suggest that Kazakhstan's capital markets have not yet reached full potential and it therefore follows that stronger domestic financial markets will underpin economic growth.

[3] See World Economic Forum. 2012. The Global Competitiveness Report 2012–2013. http://reports.weforum.org/global-competitiveness-report-2012-2013/. Geneva.

Table 3: Financial Market Development—Kazakhstan

	Value Kazakhstan	Rank/144 Kazakhstan
Availability of financial services	4.5	79
Affordability of financial services	4.0	78
Financing through local equity market	2.8	109
Ease of access to loans	2.3	110
Venture capital availability	2.2	105
Soundness of banks	4.3	120
Regulation of securities exchanges	3.7	100
Legal rights index, 0–10 (best)	4	99

Source: World Economic Forum (WEF). 2012. *The Global Competitiveness Report 2012–2013*. WEF: Geneva.

1. Small and Medium Entrepreneurship Sector

11. Small enterprises were hardest hit by the global financial crisis; 32% of small enterprises, excluding those in the process of start-up, were in liquidation in 2011 or temporarily closed, while just 3% of medium and large businesses are in this position. The small enterprise loan portfolio declined from 17% of total lending in 2007 to 12.8% in 2011, the decline mainly in construction, trade, and agriculture.

12. About 2.8 million people are self-employed, the majority (59%) in agriculture, although this number includes those in partial employment (especially women). Data from the Association of Microfinance Organizations of Kazakhstan (AMFOK) indicate that 20% of microcredit borrowers are rural, or around 70,000 borrower households out of 330,000. The banks make few microloans in rural areas and no data are available concerning lending by rural credit partnerships.

D. Financial Sector: Structure and Development

13. Kazakhstan's finance sector has three tiers: the National Bank of Kazakhstan (NBK) (level 1), the commercial banks (level 2), and other financial institutions (level 3)—the latter includes insurance firms, pension funds, and other organizations.

14. As of October 2012 the finance sector comprised 38 banks, 3 mortgage organizations, 11 pension funds, and 35 insurance companies. The finance sector is supervised by the FSC. The banks dominate the sector, with the five largest banks holding 60.8% of total banking sector assets.[4] The share of foreign banks' subsidiaries in the banking system's total assets is about 10%, whereas 65% is controlled by private domestic shareholders. Government-controlled banks account for 25% of the banking system's total assets: mainly attributable to three banks that defaulted on their debt obligations in 2009 and were nationalized.[5]

15. As the central bank and primary regulator of the banking industry, the NBK licenses and supervises commercial banks operating in the country and inspects domestic banks and local branches of foreign banks. The NBK also regularly reviews and monitors compliance with local legislation, taxes, electronic data processing, and safety issues, and regulates foreign exchange and money markets. It is fully independent in the execution of its functions within the limits of its authority provided by the laws and other legal norms and reports to Kazakhstan's president.

4 National Bank of Kazakhstan. 2012. Financial Stability Report. December. Astana.

5 Moody's Investor Service. 2013. *Banking System Outlook. Kazakhstan*. June 5, 2013.

NBK activities are regulated by the presidential decrees On the National Bank of the Republic of Kazakhstan and by other regulations, presidential decrees, and international agreements ratified by the president.

16. In April 2011, Kazakhstan's president signed a decree on the merger of the national supervisory authority—the Agency of the Republic of Kazakhstan on regulation and supervision of financial market and financial organizations—with the NBK and renamed it to the Committee for the Control and Supervision of the Financial Market and Financial Organizations (FSC) of the National Bank of the Republic of Kazakhstan.[6] The agency was separated from the central bank in 2004. The FSC remains the primary regulator of the banking sector, securities market, insurance, and pension fund industries.

17. The Kazakhstan Stock Exchange Joint Stock Company (KASE) is governed by the NBK and is self-regulated through a set of NBK-approved regulations. KASE is responsible for the regulation of its member companies in accordance with these rules and regulations, and ensures that listed companies comply at all times with its listing requirements and corporate disclosure policy. Currently, there are 56 shareholders in KASE, comprising banks, brokerage firms, asset management companies, pension funds, and other professional financial institutions. The largest shareholder is the National Bank of the Republic of Kazakhstan holding 50.1% ownership, followed by Centras Invest, a microcredit organization (with about 4.7%).[7] KASE maintains the electronic trading platform.

18. The Central Securities Depository was established as a joint stock company in 1997 as a nonprofit, noncommercial organization that provides depository and computerized book-entry settlement services. Participants in the depository include custodian banks, broker-dealers holding custodial and/or a broker-dealer license, international financial organizations, and foreign depositories.

1. Bank Performance

19. Kazakhstan's banking sector stabilized following the restructuring of three defaulted banks in 2010.[8] The pressure on the asset quality, liquidity, and profitability of the country's banks eased after a period of heightened risk and the market view 2010 as the bottoming out of the deterioration. Ongoing improvement in asset quality in the short- to medium-term is now forecast. Banks tightened credit-granting criteria, more carefully analyze loan applicants, and changed their focus from growth to consolidation.

20. However, banking sector risk remains high in Kazakhstan. According to Standard and Poor's, the Kazakh economy remains in a correction phase since the credit and real estate bubble burst in 2008, during which banks' nonperforming and restructured loans will remain high as recoveries of problem loans, particularly to the construction industry and in case of fraud, are a lengthy process. High credit risk takes into account the banks' history of aggressive underwriting standards and the country's weak payment culture and rule of law. Banks' risk appetites remain aggressive and prospects for recovery in profitability are distant, given margin pressure and poor asset quality. This is evidenced by losses over the past four years in the banking system. Banking regulators are considered to lack independence and be subject to

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6 Committee for the Control and Supervision of the Financial Market and Financial Organizations (FSC) of the National Bank of Kazakhstan. Committee history. http://www.afn.kz/index.cfm?docid=516

7 For full list of shareholders, please see: http://www.kase.kz/en/shareholders.

8 The three were BTA Bank, Temirbank, and Alliance Bank. In January 2012, BTA Bank defaulted on interest payments and asked for a second restructuring. External creditors and BTA Bank formed a credit committee in March 2012. The restructuring plan is currently under discussion.

political interference. The industry's systemwide funding profile has improved in recent years, notably the reliance on cross-border resources has reduced markedly.[9] The vulnerability of the Kazakh banking sector is underscored by Moody's who identify three key risks: (i) large overhang of problem loans requiring higher loan-loss reserved, (ii) poor profitability and capital adequacy, and (iii) modest credit growth.[10]

Box 1: Main Considerations in Standard & Poors Banking Industry Country Risk Assessment: Kazakhstan 22 August 2013

Strengths:
- Good economic growth prospects and rising GDP per capita.
- Strong fiscal and external balance sheets.
- Strengthened funding profile of domestic banks.

Weaknesses:
- Extremely high credit risk in the economy, given aggressive lending and weak underwriting standards.
- Inability of regulators to clean up the banking system of very high levels of problem loans post-crisis.
- Low risk-adjusted returns of the banking system, significantly affected by low profitability of larger players.
- Weak governance and transparency and a high incidence of corruption and fraud in the banking sector.

Source: Standard and Poor's Ratings Services. 2013. *Banking Industry Country Risk Assessment: Kazakhstan*. August 22. 2013. www. Standardandpoors.com/ratingsdirect

2. Credit Organizations

21. In the Vision Paper 2010, the FSC acknowledged the role of microfinance organizations in society, but was concerned about the systemic risk of credit partnerships and microcredit organizations.[11] A new law on microfinance organizations, including regulation and supervision by the NBK, was adopted by parliament on 26 November 2012. The new law requires all microcredit organizations to convert to microfinance organizations within three years. Under the law, microfinance organizations differ from microcredit organizations in that the former are registered and supervised by the National Bank of Kazakhstan, the country's central bank. The law will require microfinance organizations to fully disclose to borrowers the cost of loans, including the total amount to be repaid. It will establish a minimum charter capital for microfinance organizations of KZT 30 million (USD 197,000). Also, it will prohibit non-bank financial institutions from advertising themselves as creditors without either status as a loan cooperative or valid registration as a microfinance organization. As microfinance institutions they can, besides lending, engage in other activities: attract grants and loans, excluding loans from the public; provide leasing services; provide insurance on behalf of insurance companies; provide advisory services; and, educate clients.

22. As of July 2013 there were 1,735 microcredit organizations of which 834 were operational. The total number of loans of all MFIs amounted to 102,231 and the total amount was $224 million. Of the 46 that report to MixMarket there the total loan portfolio was $380 million and the total number of borrowers was 144,000.[12]

23. Commercial banks do not maintain data on their microcredit lending. As a result of crisis 2008-2009 banks of Kazakhstan sharply reduced their lending in general, and small business

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9 Standard and Poor's Ratings Services. 2013. *Banking Industry Country Risk Assessment: Kazakhstan*. August 22. 2013. www. Standardandpoors.com/ratingsdirect

10 Moody's Investor Service. 2013. *Banking System Outlook. Kazakhstan*. June 5, 2013.

11 Credit partnerships are sometimes called credit cooperatives.

12 www.mixmarket. http://www.mixmarket.org/mfi/country/Kazakhstan accessed October 2013.

lending in particular. The share of lending to small businesses in the total portfolio decreased from 22% in 2009 to 14% in 2012.

3. Insurance Companies

24. At the beginning of January 2012, Kazakhstan had 38 insurance companies with total assets amounting to T387.7 billion.[13][14] Retirement annuities—due to a lump sum at the conclusion of contracts of insurance annuity—are gaining popularity. The share of annuities in the structure of the insurance portfolio of life-insurance companies was close to 70%, compared with a share of less than 30% in 2006. However, legislative changes introduced by the FSC to limit the amount of the lump sum at the conclusion of contracts—as well as an increase in the minimum amount necessary for pension annuities in 2011—could significantly reduce demand for retirement annuities. By October 2012, 35 insurance companies were operating, according to the NBK.

4. Securities Market

25. The capital market in Kazakhstan has its origins in the introduction of the national currency on 15 November 1993. On 17 November, the central bank and 23 leading commercial banks established a currency exchange,[15] aiming to organize and develop the tenge and the Kazakhstan Interbank Currency Exchange, now known as KASE. KASE was incorporated and registered with the Ministry of Justice as a commercial, self-regulated, closed joint stock company on 30 December 1993.

26. Kazakhstan has the largest stock market in Central Asia, both relative to GDP and in absolute terms.[16] Among its global peers, relative to GDP, its equity market ranks 49th out of 97 countries—ahead of the Ukraine, at 55th by 2012. As of 1 January 2012 stock market capitalization of listed companies was $43.3 billion, with the Ukraine having $25.6 billion. Relative to GDP, stock market capitalization of listed companies in Kazakhstan was approximately 23.0% by the beginning of 2012, versus 15.6% in the Ukraine. Kazakhstan's equity market grew steadily from 2001 through to 2006, corrected in 2007, recovered and grew during the first half of 2008, after which it fell abruptly. Throughout 2009, the market increased gradually and reached its peak in spring 2011 (market capitalization exceeded $120.0 billion), which was followed by a dramatic decline. During 2012 and 2013 the market had a negative tendency of slow decrease.

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13 xPrimm.com. Fiscal year 2011 Insurance Companies Ranking-Kazakhstan. http://www.xprimm.com/Kazahstan-2,12,32.htm. As of 01 July 2012 there were 36 insurance organizations. Financial Supervision Agency. 2012. Information for entities of financial market. http://www.afn.kz/index.cfm?docid=599..

14 Total balance sheet on insurance (reinsurance) organizations of Kazakhstan on 1 January. Committee for the Control and Supervision of the Financial Market and Financial Organizations (FSC) of the National Bank of Kazakhstan.. 2012. http://www.afn.kz/?docid=572.

15 Prior to this, the Centre of Interbank Currency Transactions existed as a subdivision of the National Bank of Kazakhstan.

16 World Bank. WorldData Bank. *World Development Indicators*. http://databank.worldbank.org/data/views/reports/tableview.aspx.

Table 5: Kazakhstan—Key Financial Metrics

	2005	2006	2007	2008	2009	2010	2011	2012
GDP (current $ billion)	57.12	81.00	104.85	133.44	115.31	148.05	186.40	200.50
Market capitalization of listed companies (% of gross domestic product [GDP])	18.42	53.93	39.46	23.29	50.00	41.03	23.03	11.70
Central government debt (total as % of GDP)	7.05	5.94	5.32	6.33	9.51	10.20	10.00	11.70
Domestic credit to private sector (% of GDP)	35.69	47.78	58.94	49.65	50.27	39.30	36.30	37.20

GDP = gross domestic product; ... = not available.
Central government debt in 2010 (including both domestic and external and guaranteed by the central government) was $21.9 billion or 14.8% of GDP, as per statistics from the Ministry of Finance.
Source: World Bank. World Development Indicators.
http://databank.worldbank.org/data/views/reports/tableview.aspx. Accessed October 2013.

5. Pensions

27. A pension reform law was introduced in 1997, and pension funds in 1998. Initially pension contributors favored the state fund, but as confidence in private pension funds has grown these entities have attracted a greater share of contributions. In implementing pension reform, Kazakhstan's government adopted the 3 pillar structure Chile follows. Since 1998 assets under management for accumulative pension funds have grown progressively and were estimated to be $17.9 billion as of January 2012, about 10% of GDP. In January 2012 a multi-portfolio system was introduced requiring pension assets to be invested in portfolios adopting conservative, moderate, or aggressive investment strategies.

28. In January 2013 the president instructed the government and the NBK to merge the country's 11 second-pillar pension fund accounts into a single entity, the Single (Unified) Accumulative Pension Fund, under the NBK (or the Ministry of Finance) and transfer to it approximately $20 billion of funds accumulated to allow for more efficient and safe management of citizens savings. This move is expected to increase banks' and nonbank financial institutions' participation in the market for government paper, as demand for such paper from pension funds declines, could provide support to the NBK's move to more active open market operations. It is not clear what role of private asset management companies will be in this merger. Proposals were expected to be developed in 2013.

30. NBK management and transition is not without risks, and close collaboration between the Ministry of Finance and the NBK will be crucial to avoid exacerbating fiscal risks and undermining earlier reform efforts, including by making up for eliminating competition in the market for pension services. The authorities need to fully abide by their intentions to (i) develop a clear and sound market-based investment strategy for the assets, (ii) secure management independence with arms-length contracts (preferably with reputable international advisors), and (iii) ensure that individual accounts are maintained.

6. Leasing Services

31. The Leasing Law of 2000 regulates leasing activities, with amendments in 2011 that make leasing an attractive financing option. State-owned leasing companies dominate the leasing market: KazAgroFinance (100% state owned and a subsidiary of KazAgro, a state holding company), Astana Finance Leasing (a subsidiary of Astana-Finance 14.20% owned by the State Property Committee of the Ministry of Finance and 3.92% by the sovereign wealth fund Samruk-Kazyna, as of January 2010) and the Development Bank of Kazakhstan leasing

subsidiary DBK Leasing (100% state owned). Other major private leasing companies include Halyk Leasing, BTA Orix Leasing, Kazkommertsbank, and Centerleasing. In 2009 the value of leasing contracts was $1.4 billion, equal to 3% of aggregate bank lending, with agricultural equipment accounting for the major share of transactions in the market. There are 46 registered leasing companies, although only 15 are actually operating. The central bank regulates or supervises leasing companies affiliated to banks.

7. Loan Security

29. The First Credit Bureau was established in September 2004 as a commercial organization, supported by the Financial Institutions' Associations of Kazakhstan in close cooperation with The Pragma Corporation (funded by the United States Agency for International Development [USAID]). The First Credit Bureau, as the name suggests, was the first credit bureau in Kazakhstan to conduct centralized collection, storage, and processing of data, as well as to form credit histories and issue credit reports. Its clients include more than 60 organizations in Kazakhstan, enabling the creation of a sizeable database containing more than 3.9 million credit histories and more than 11.0 million credit contracts. Seven of Kazakhstan's leading commercial banks are shareholders, as are financial organizations and CreditInfo SCHUFA.[17] Its main products and services include credit reports on individuals and on legal entities (both in extended, standard, and reduced formats).

8. Challenges and Risks

30. Challenges include (i) the debt restructuring of banks, (ii) the further reform of the pension system, (iii) increasing access to finance for small and medium-sized enterprises, (iv) development of adequate policies and measures to support the capital market, and (v) enhancing the finance sector's regulatory framework and the capacities of the FSC, the National Bank of Kazakhstan, and the Ministry of Finance.

31. Kazakhstan's banking sector has been characterized by a weak regulatory track record, governance, and transparency, as well as corruption and fraud.

32. Its small and medium-sized enterprises, meanwhile, suffered significant impact from the global financial crisis and have limited access to finance, especially in rural areas, reducing the private sector's share in GDP.

33. The pension sector's issues are mostly related to a regulatory imbalance that constrains the sector's development and to the lack of profitable investment instruments (with yields higher than inflation) in an insufficient capital market.

34. Capital market infrastructure and regulatory issues require unified and consistent state policy to ensure sustainable growth and to support economic growth. The lack of a government benchmark bond program also prevents development of the capital market and related sectors.

[17] First Credit Bureau. http://www.1cb.kz/index/razdeli/c/1/i/2/?langen.

II. Sector Performance, Problems and Opportunities

A. Banking Sector

35. The banking sector comprises 38 second-tier banks supervised by the Financial Supervision Agency (FSC).[18] The financial sector is dominated by the second-tier banks, with T14,788.4 billion ($97.6 billion) in total assets as of 1 June 2013.

36. The NBK refinancing rate has been 5.5% since 4 June 2012. Loans to individuals through second-tier banks generally bear an interest rate of 19.5% if in tenge and 13.9% if in foreign currency. Three- to twelve-month term deposits earn 8.0% on tenge deposits and 4.8% on foreign currency deposits. The effective yield on 60-day government securities was 3.02% in November 2011, compared with 4.91% at the end of 2010. No data are available for the weighted average cost of funds of banks.

37. Up to 2008, banks were reliant on external financing for asset growth, with external liabilities making up about 45% of the aggregate balance sheet. The loan-to-deposit ratio in 2007 reached 228.[19] Easy access to external funding fueled rapid domestic credit growth, which expanded by 81% in 2006 and 55% in 2007, bringing bank credit to 70% of GDP by the end of 2007, compared with less than 40% in 2005. In 2008, the refinancing requirements of banks for their external borrowing amounted to more than $8 billion and up to a further $6 billion in repurchase agreements (repos) and short-term deposits. The global financial crisis meant this refinancing was not available and the government was forced to take steps to refinance banks out of reserves and the National Oil Fund.[20]

38. In 2008, 44% of total lending had been in foreign currency (despite many borrowers not having revenue streams in foreign currency) and 80% was medium- to long-term. Much of the lending had been secured by steadily increasing values in real estate, which collapsed by 40% in value in 2008–2009 (based on the Almaty value index). The value of the tenge was maintained against the US dollar until 2009, when the central bank depreciated it by 22%. These economic factors, coupled with lax management of loan portfolios, led to a rapid increase in nonperforming loans,[21] which were T236.00 billion ($1.95 billion and 2.7% of gross loans outstanding) at the end of 2007 and T3.60 trillion ($24.50 billion and 37.8% of gross loans) at the end of 2009 (see Appendix 4, Table A4.1).

39. The National Bank of Kazakhstan targeted Basel III and full compliance with International Financial Reporting Standards by 1 January 2013.

1. Restructuring of the Largest Banks: 2009–2011

[18] The responsibility for supervision of the finance sector earlier lay with the Agency of the Republic of Kazakhstan on regulation and supervision of financial market and financial organizations. This agency was abolished in April 2011 and its responsibilities transferred to the Committee for the Control and Supervision of the Financial Market and Financial Organizations of the National Bank of Kazakhstan. The committee is known as the Financial Supervision Agency for short.

[19] The average gross loan-to-deposit ratio is estimate to have declined to 136% as of the end of 2012. Moody's 2013.

[20] The National Fund of the Republic of Kazakhstan was created in 2000 as a stabilization fund to ensure the Kazakhstan economy would be stable amid price swings in oil, gas, and metals. The National Bank of Kazakhstan monitors the fund's assets. These were drawn down during 2008–2009 to offset the effects of the financial crisis. The fund purchased Samryk-Kazyna bonds to enable Samryk-Kazyna to recapitalize BTA Bank and Bank Alliance. At the end of 2011, the fund's foreign international reserves stood at $43.6 (the latter figures refers to intern. reserves of NBK) billion.

[21] Defined here as loans classified as bad and category 5 of doubtful loans.

40. By October 2008, the government had formulated plans to prevent a feared systemic collapse of the banking system. It decided to recapitalize the four largest banks by buying minority shares and placing deposits with the banks. As of the end of 2008, the net worth of BTA Bank was negative $9.9 billion (not including a negative net worth in its subsidiary Temirbank of $560.0 million). Alliance Bank had a negative net worth of $3.0 billion. Kazkommertsbank and Halyk Bank were in better positions, with positive net worth of $1.8 billion and $1.6 billion respectively, although Kazkommertsbank did have substantial exposure to foreign liabilities and high nonperforming loans. The downward spiral in real estate values and the expected depreciation of the tenge, coupled with liquidity problems in BTA Bank, altered the restructuring plans for BTA Bank and Bank Alliance. In February 2009, the government acquired control of BTA Bank through a share issue by the state holding company Samryk-Kazyna and took control of Alliance Bank through an escrow arrangement. Later in 2009, the government negotiated a debt write-off by foreign creditors of $10.0 billion for these two banks. The state holding company, Samryk-Kazyna, also swapped bonds with the two banks, which will be converted to equity later. Following these transactions, Samryk-Kazyna held 81.48% of BTA Bank, 79.90% of Temirbank, and 67.00% of Alliance Bank. Samryk-Kazyna also held a minority interest (21.30%) in Kazkommertsbank and 20.90% in Halyk Bank.[22] Deposits in the banking system grew after these steps were taken, and the aggregate loan portfolio has grown 6% since 2010 (after an inflation adjustment.

41. But the restructuring is an ongoing requirement for BTA Bank, Alliance Bank, and Temirbank. Due to a lack of buyer interest for the purchase of government financial institutions, authorities have abandoned the plan to sell off Temirbank and there has been discussion of the feasibility of merging it with Alliance Bank. Such a merger may be difficult as (i) the two banks serve similar markets, (ii) Alliance Bank appears to have a weak net worth position,[23] (iii) Temirbank is further advanced in the adoption of International Financial Reporting Standards (IFRS), and (iv) major creditors have yet to express the willingness to explore the possibility of a merger. In January 2012, BTA Bank missed a coupon payment on its July 2018 dollar bonds, prompting Samryk-Kazyna to consider further restructuring of BTA Bank.[24] Nonperforming loans for BTA Bank amounted to $10.30 billion at the end of 2011 (73.0% of the total loan portfolio), $1.86 billion (49.5%) for Alliance Bank, and $827.00 million (55.4%) for Temirbank (Appendix 4, Table A4.2). The net worth of BTA Bank is -T240.79 billion (about -$1.63 billion). For Bank Alliance, the total value of nonperforming loans is more than 31 times net worth, and for Temirbank it is 1.8 times. Excluding these three banks, aggregate nonperforming loans for the remaining banks amount to 1.2 times aggregate net worth.

2. Loan Loss Provisioning 2007–2011

a. Overall description

42. At the end of 2007, total loans outstanding amounted to T6.64 trillion ($73.40 billion) with loan loss provisions of T520.20 billion: 6% of the total loan portfolio (Appendix 4, Table A4.1). Lending peaked in 2008, with loans outstanding of T9.24 trillion ($76.50 billion). Loan loss provisions crept up to 11% of the loan portfolio. In 2009, the loan portfolio shrank 15% in US dollar terms and a further 5% in 2010, reaching T9.1 trillion ($61.5 billion) at the end of 2010, with loan loss provisions reaching 38% of the loan portfolio by the end of 2009, 31% by the end

[22] Halyk Bank has repaid all funds received from Samryk-Kazyna.
[23] The provisional net worth at the end of 2011 was stated as T8.7 billion ($59 million). In early 2012, this was adjusted to -T3.6 billion (-$24.4 million).
[24] Public statements from the Head of Samryk-Kasyna 26 January 2012.

of 2010, 32% by the end of 2011, and 34% by the end of 2012. Loans classified as standard are in the minority: 40% of total lending in 2007 and 26% by 2011 (Table A4.1).[25]

43. It is not only classified loans that have increased in size and proportion, but so have loans at higher risk. This accumulation of bad loans is largely due to tax disincentives related to loan write-offs. The amount of loans classified as standard has declined and loans classified as doubtful (categories 3 to 5) and bad have increased substantially.[26] As of the end of 2011, category 5 and bad loans amounted to T3.75 trillion ($25.40 billion). Nonperforming loans were 2.6% of the loan portfolio at the end of 2007 and 35.9% at the end of 2011. Overdue interest increased from T306.00 billion in 2007, reaching T1.15 trillion ($7.80 billion) by the end of 2011.[27] In November 2012 the share of nonperforming loans were around 36% of total loans, a high figure by international standards.[28].

44. By sector, nonperforming loans are highest in retail trade (23.6% of the total), followed by construction (20.9%), real estate operations (10.2%), and manufacturing (9.1%).[29] The share of mortgage loans in the loan portfolio as of 1 October 2011 accounted for 32.8% of total lending and 39.0% of nonperforming loans. More than half of mortgage loans exceed 70.0% of the value of collateral. Risk is concentrated, with the 25 largest borrowers holding 35.6% of the aggregate loan portfolio in the third quarter of 2011.

45. After declines in lending in 2009 and 2010, lending increased a nominal 15% in 2011 to reach aggregate gross loans outstanding of T10.44 trillion ($70.61 billion). Over the same period, deposits, largely from state entities, increased 14%. But high levels of overdue interest income, extensive use of loan restructuring, and the low profitability of many banks pose risks to capital adequacy ratios.

b. Impact of Tax Regulations

46. Banks and commercial legal entities are taxed at a flat rate of 20.0%. Until the end of 2011, a reduction in loan loss provisions through the writing off of a nonperforming loan was treated as taxable income unless the bank could show it had taken stringent steps to recover the loan. This tax process acted as a strong disincentive to write off bad debt, with the result that bad debt accumulated on bank balance sheets to reach T2.27 trillion ($15.40 billion) by the end of 2011 and 21.8% of gross loans outstanding. Instead of writing-off poorly performing loans, banks resorted to a process of loan restructuring (usually an extension of the loan term) such that, by 1 October 2011, restructured loans comprised more than 18.0% of the total loan portfolio.[30]

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[25] Systemwide nonperforming loans (NPLs, loans more than 90 days overdue) under local regulatory standards reduced slightly to 30.0% of total loans at mid-2013 from the peak of 31.9% at March 31, 2012, according to regulatory data.

[26] A less rigorous classification of loans in 2007–2008 overestimated loan quality at that time. Concern remains that loans have been restructured/refinanced without proper classification and adequate provisioning.

[27] The estimated level of problem loans as of year-end 2012 was 40%. Moody's Investor Service. 2013. *Banking System Outlook. Kazakhstan*. June 5, 2013.

[28] Economist Intelligence Unit. 2013. *Industry Report. Financial Services. Kazakhstan*. January 2013.

[29] National Bank of Kazakhstan. 2011. Risks of Financial Intermediation Institutions. *Kazakhstan Financial Stability Report* (Figure 3.2.6 in Report III) (in Kazakh). December. http://www.nationalbank.kz/?docid=605.

[30] National Bank of Kazakhstan. 2011. "Financial Stability Report of Kazakhstan."

47. An amendment to the tax code allowed banks to write-off bad debt without incurring a tax liability providing that they followed National Bank of Kazakhstan regulations.[31] But this amendment only applied during 2012. The amendment also stated that if, under IFRS accounting procedures now required of all banks, loan loss provisions became smaller than had been earlier booked under the previous accounting system, then the amount of the reduction would be taxable.

48. Not all banks have converted fully to IFRS requirements, which banks were required to adopt by 1 January 2013. Most banks have yet to fully estimate the conversion from International Accounting Standard 39 (Financial Instruments: Recognition and Measurement) to the IFRS 9 standard of amortized cost or fair value—and the impact of this—and it is seen as raising the level of uncertainty. The value of a financial asset will be the discounted value of cash flow expected from that asset. The final workout status is unknown. First, there is the possibility of a decline in the value of financial assets, which would result in a decrease in net worth and the capital adequacy ratio: some banks would need additional equity. Second, banks may need to lower their loan loss provisions, which would partially protect their net worth, but would result in an increase in income tax to be paid based on the amount of the reduction of loss provisioning. Some other banks may discover that their amount of loss provisioning is inadequate compared with the adjusted value of financial assets. Under IFRS 9, issued in two parts in November 2009 and October 2010, banks can elect not to restate prior periods.

49. The future required treatment of accrued interest revenue also introduces uncertainty to the valuation of the net worth of the banks. In an extreme case, assuming all accrued interest of T835.8 billion ($5.6 billion) were overdue more than 60 days, an estimated T668.0 billion ($4.5 billion) would be wiped off the net worth of banks. Their consolidated net worth would decline from 11.7% of total assets to 3.4%.[32]

1. Strengthening the Banking Sector

a. Proposals for Debt Restructuring of Banks

i. Government Policy and Strategies

50. The Council for Financial Stability and the Development of the Financial Market of the Republic of Kazakhstan was approved a conceptual plan to improve the quality of banks' assets.[33] The plan aims to remove nonperforming loans with an approximate face value of $6 billion (about 37% of the total) from banks' main balance sheets to facilitate a resumption of lending, while limiting costs and mitigating moral hazard. If successful, the plan is expected to be expanded, drawing in the participation of both domestic and foreign investors. The initial concept is for the plan to proceed in the following three complementary directions:

(i) Establishment by banks of special purpose vehicles to act as private asset management companies. These would receive problem assets related to real estate and land assets with a face value of around $4 billion.

(ii) Establishment of a distressed asset fund. This fund would be owned by the central bank and capitalized with $1 billion raised through a restricted domestic

[31] Law No. 467-IV of the Republic of Kazakhstan, of 21 July 2011: On Changes and Amendments to Certain Legislative Acts on Taxation.

[32] These calculations exclude BTA Bank (T316.7 billion accrued interest equivalent to $2.1 billion), and assume that the losses incurred in writing off accrued revenues would be tax deductible.

[33] The outline of this plan is drawn from the International Monetary Fund June 2011 Article IV Report.

debt placement (among pension funds, banks, and the central bank). The fund would purchase and dispose of other nonperforming loans worth $2 billion (with an assumed average discount of 50%). The interest rates on the bonds would vary, favoring pension funds as the senior bondholders.

(iii) Enhancement of prudential regulations and capital adequacy. Regulatory standards would be harmonized with best international practice and the Basel III framework, including by strengthening core capital and reducing systemic risks through dynamic provisioning and enhanced capital buffers.

51. It is proposed that the asset management companies would be owned by banks, either individually or collectively. No new funding would be involved and the distressed asset fund would be time-bound (with a maximum 5-year life) and consolidated into the balance sheet of the central bank.

52. Valuation. Under both schemes, asset valuation would be undertaken by independent external advisors, including the big four accounting firms and based on an assessment of cash flows and net realizable values.

53. Management. Bank staff familiar with the loans and outside professionals would manage the asset management companies. External managers would manage the distressed asset fund and report to the central bank.

54. Governance. Transparency of the valuation of bank level asset management companies would depend on the extent to which they are consolidated into the main balance sheets of banks. The distressed asset fund would be audited and the results made public.

55. Government expectations of impact of the plan. For asset management companies, assets would be transferred at an agreed valuation. But they would be subject to more lenient provisioning requirements, which could boost capital positions under local accounting rules, although, under full IFRS accounting, there would be no change. The better focused and more professional management of bad assets should allow a higher rate of loan recovery and, under the distressed asset fund, banks would swap provisioned nonperforming loans for bonds at a value determined by independent assessors. To the extent that the valuation differs from the net book value, it would impact the balance sheet. Banks would gain extra liquidity as they could use the bonds in repurchase agreements with the central bank.

ii. Industry Response to Debt Restructuring

56. The banks agree that there is a need to establish special purpose debt recovery units. The better managed banks appear to believe that these should remain in-house. One well-managed bank stated that it will learn from the restructuring process and this will strengthen internal management of loan portfolios. The same bank questioned the availability of the professional managers that would be needed to manage separate and autonomous special purpose vehicles. Other banks lean towards the establishment, and possible sale, of the special purpose vehicle, in which the banks might hold some ownership. Financial service professionals suggested that the special purpose vehicle and distressed asset fund proposals are coming too late and are more applicable to the three restructured banks than the industry as a whole. There are also concerns about the (uncertain) amount of contingent liabilities that would remain with the banks even after the sale of distressed assets to special purpose vehicles/distressed asset fund. The government plans would also require the approval of creditors of the involved banks and this might delay the restructuring process. One bank said that because the distressed asset

fund proposal would apply only to lending not secured against real estate, this would exclude most of its borrowers and loan portfolio from the distressed asset fund.

57. Many loans have been restructured with longer repayment terms. Banks, with the support of professional accounting and management firms, are also working with the larger corporate borrowers to restructure their debt and improve their earnings. But very little of such assistance is being provided to micro and small businesses either by the banks, professional firms, or the DAMU Small Entrepreneurship Development Fund (DAMU).[34] Although amendments have been proposed to the Law on Bankruptcy to facilitate the rehabilitation of businesses and the settlement of creditor claims, the efficacy of the proposed amendments is unclear and untested.[35] The amendments, for example, do not provide a ranking among secured creditors as described in Article 47 (Settlements with creditors) and Article 75.3 (Order of priority in distribution of the bankrupt's estate).

b. Governance, Internal Controls, and Transparency

58. The Law on Risk Minimization was passed in December 2011 to improve the supervision of bank conglomerates.[36] It will introduce greater transparency in the activities and sources of capital of financial institutions, improve the corporate governance in financial institutions and joint stock companies, and ensure more timely and accurate disclosure of information. It will also improve legal mechanisms for restructuring of banks within bank conglomerates, update procedures for restructuring of liabilities, and raise bank supervision and regulation to international standards. The law will also establish an effective system for the protection of investor rights to raise investor confidence in the securities market and further develop accumulative pension funds and investment fund operations.

59. The Law on Risk Minimization should fit well with IFRS 7 and IFRS 10. IFRS 7 (introduced in 2007 with subsequent amendments through to 2011) relates to Financial Instruments: Disclosures that require extensive qualitative and quantitative information explaining the significance of financial instruments to a bank’s financial statements, its exposure to risk, and how this exposure is managed. IFRS 10 relates to Consolidated Financial Statements, which will be applicable to annual reporting periods beginning on or after 1 January 2013. The IFRS 10 Standard requires a parent to present consolidated financial statements as those of a single economic entity, replacing the requirements previously contained in International Accounting Standard 27 Consolidated and Separate Financial Statements and Standard Industrial Codes (SIC)-12 Consolidation - Special Purpose Entities. The standard identifies the principles of control, determines how to identify whether an investor controls an investee and therefore must consolidate the investee, and sets out the principles for the preparation of consolidated financial statements. The standard introduces a single consolidation model for all entities based on control, irrespective of the nature of the investee. If banks were to establish special purpose vehicles in which they hold a share, the accounting for these would follow IFRS 10 procedures.

60. The Law on Risk Minimization will be applied to banks and their affiliated companies through the National Bank of Kazakhstan Department of Surveillance and Control Methodology.

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[34] DAMU supports small and medium businesses.

[35] Law of the Republic of Kazakhstan dated January 1, 1997 № 67-I On Bankruptcy (with alterations and amendments as of 17.07.2009).

[36] Law of the Republic of Kazakhstan dated 28 December 2011: On Amendments to Some Legislative Acts of the Republic of Kazakhstan Related to Regulation of Banks and Financial Organizations with Regard to the Risk Minimization.

The scope of work for this department is vast and challenging. Technical support in establishing and piloting methodologies and procedures, and the evaluation of these could be useful.

2. Housing Loans and Household Debt

61. The affordability of housing and housing loans is a social and economic concern—especially in Astana and Almaty. A general calculation of housing space requirements is 20 square meters per person: for a family of four this would be 80 square meters. In Astana/Almaty, the cost of such an apartment is at least $120,000 ($1,500 per square meter).[37] A loan equal to two-thirds of this value ($80,000) would result in interest and principal payments of $21,890 a year based on a loan term of seven years and an interest rate of 19.5% a year. The wage income required to service such a loan would be around $66,000–$87,000 a year, well above the national average wage of $9,000. Extending the loan term to 20 years would still require annual debt servicing of $16,000, well beyond the repayment capacity of most families. As a consequence, there is overcrowding within apartments, many families rent rather than purchase apartments, and many borrowers are unable to fully meet loan repayment responsibilities. Apartment prices may need to decline further. A decline in loan interest rates, coupled with longer repayment terms, would also alleviate the situation. For example, a 20-year loan of $60,000 at 10% annual interest would result in debt servicing of $7,050 a year, almost within the reach of a household with two income earners.

62. The Housing Construction Savings Bank (HCSB), a state-owned bank, with funding from Samruk-Kazyna, lends amounts equal to a borrower's deposits, with a subsidized interest rate of 5% a year. At end of 2011, its loan portfolio stood at T90.7 billion ($615 million). Based on a $120,000 apartment, the loan would be $60,000, which on a 20-year basis would entail annual debt servicing of $4,814, below the cost of renting at about $500–$1,000 per month. During 2011, HCSB increased its loan portfolio by T22.98 billion ($155.80 million), 34% more than the loan portfolio at the end of 2010, but less than 1% of households. As of the end of 2011, 98% of the HCSB loan portfolio was classified as standard and category 1. The requirement that a deposit be equal to half the cost of housing makes sound financing sense, but likely removes access to HCSB loans for most low- and middle-income families.

63. Since 2008, household debt has improved nationally, decreasing from 41% of income to less than 19% at the end of 2011, creating scope to expand lending to households.

3. Lending to Business

64. Table 6 shows the number of small, medium, and large businesses established as legal entities. The business size category is according to number of persons employed: for a small enterprise it is up to 50 persons, for a medium enterprise it is 51–250 persons and for a large enterprise it is more than 250 persons as defined by the Law N 124-3, On Private Entrepreneurship, dated January 31, 2006.

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37 Subsidized housing is available to people in specified professions, such as nurses and teachers, at $700 per square meter.

Table 6: Number of Legal Entities (as of August 2011)

Size	Total Number of Entities	Agriculture	Non-Agriculture
Small	278,814	11,824	266,990
Medium	13,699	606	13,093
Large	2,344	139	2,205
Total	**294,857**	**12,569**	**282,288**

Source: The Agency of Statistics of the Republic of Kazakhstan. 2011. "The List of Registered Juridical Persons in Aspect of Activity Category." Astana.

65. The law, On Private Entrepreneurship, defines entrepreneurship as follows:

(i) Small entrepreneurship: Individual entrepreneurs not being a legal entity and employing up to 50 persons; and legal entities employing up to 50 persons, whose value of assets does not exceed 60,000 times the monthly assessment index, which is defined for the respective year by the law on the republic's budget. However, some activities may lead to not being classified as small entrepreneurship, including banking, insurance, and other activities as stated in the above mentioned law.

(ii) Middle entrepreneurship: Individual entrepreneurs not being a legal entity and employing more than 50 persons; and legal entities employing 51–250 persons or legal entities whose value of assets is up to 325,000 times the monthly assessment index.

(iii) Large entrepreneurship: Legal entities employing more than 250 persons or legal entities whose value of assets is 325,000 times higher than the monthly assessment index.

66. In Kazakhstan, small enterprises were most severely impacted by the global financial crisis. Some 32% of small enterprises were in liquidation at least temporarily in 2011, excluding those in the process of start-up, compared with just 3% of medium and large businesses. At the end of 2007, small enterprises had T1.51 trillion ($12.47 billion) in loans outstanding from banks, shrinking to T1.34 trillion ($9.07 billion) by the end of 2011, a decline of 27% in US dollar terms.[38] The small enterprise loan portfolio as a percentage of total lending declined from 17.0% in 2007 to 12.8% in 2011, the decline mainly in construction, trade, and agriculture. This decline in lending occurred even though DAMU held about T13.3 billion ($90.0 million) at the end of 2010 in lending and loan restructuring support to small and medium enterprises. Loan loss provisions on this lending amounted to T10.9 billion (82%), or $73.7 million. The average small-enterprise loan balance is at least $61,000.[39] There is no data on the number of borrowers according to loan size.

67. The decline in lending raises the question as to whether small and medium enterprises—especially small—are receiving needed support. DAMU has provided training for more than 16,500 small- and medium-enterprise trainees, but much of the focus has been on supporting credits to small and medium businesses through the banks.[40] This may have

[38] National Bank of Tajikistan data.
[39] Based on the assumption that up to 148,000 small enterprises received loans, including 99,870 active small enterprises, 4,468 under liquidation, and 43,680 temporarily inactive.
[40] This is equal to less than 10% of total small and medium enterprises that are active, under liquidation, or are temporarily inactive. It is likely that more than one person was trained per enterprise and some trainees would have attended more than one course.

assisted the banks more than the enterprises, and it appears that enterprises in financial difficulty and needing financial or managerial restructuring or improvement are getting little training and advisory support. Such training would cover the management of receivables, insolvency, rehabilitation of businesses, risk-associated budgeting and planning, and more appropriate selection in and use of debt instruments.

68. Table 7 shows that 2.77 million people were self-employed in 2012, 59% of them in agriculture, although this number includes those in partial employment, especially women. Since only an estimated 199,000 small farms are not "legal entities", there is under-employment in rural areas.[41] AMFOK data indicate that 20% of microcredit borrowers are rural—around 70,000 borrower households out of 330,000. The banks make few microloans in rural areas and no data are available concerning lending by rural credit partnerships. The AMFOK data indicate less than 10% of rural households have access to credit services, while the urban self-employed fare better, totaling around 1 million. Microcredit organizations have 260,000 borrowers in urban areas, 1% of households. In addition, the banks provide more than a million micro- and small-scale retail loans. More than 50% of urban households are likely to apply for a credit.

Table 7: Self-Employment by Sector (million, 2012)

Sector	Entire Population	Male	Female
Agriculture	1.52	0.73	0.79
Industry	0.04	0.02	0.02
Construction	0.15	0.12	0.04
Retail/wholesale trade	0.62	0.27	0.35
Transportation	0.18	0.16	0.02
Other	0.18	0.09	0.09
Total	**2.69**	**1.39**	**1.30**

Source: The Agency of Statistics of the Republic of Kazakhstan. 2013. "Self-Employed Population by Economic Activity." Astana.

69. The expansion of electronic banking (e-banking) services will facilitate access to a greater range of financial services in rural areas. The evaluation of micro and small rural loans, however, will require loan staff who know the borrower's circumstances. Loan staff will therefore be needed within rural communities. Because bank branching is expensive for banks in sparsely populated rural locations, microcredit organizations have the opportunity to expand low-cost basic services into these areas.

4. Bank Sector Performance

70. Reviews of Kazakhstan's banking sector tend to focus on the largest banks, the three banks that have been restructured, and the aggregate performance of all banks. In the 12 months to the end of 2011, the aggregate net income of the banking sector was T39.0 billion ($264.0 million) on total assets of about T12.8 trillion ($86.9 billion) and net worth of about T1.31 trillion ($8.8 billion). The return on average total assets was 0.31% and 2.96% on average equity (Table A4.3). The 10 largest banks accounted for 80% of total assets, 84% of net loans

[41] The data suggest there are an average of eight self-employed people per farm, too many for a small farm. The Agency of Statistics shows 1,611,338 rural households with an average 4.75 people per household. Similar data are not shown for urban areas, but at 4 people per household there would be 2.26 million urban households. The total of urban and rural households is therefore estimated at 3.87 million.

outstanding, 59% of net worth, and 42% of net income. Their return on assets and on equity was below the industry average, due largely to the inclusion of BTA Bank and Alliance Bank in their ranks. Their growth in loan portfolio was 10%, compared with 34% from the remaining banks. Even excluding BTA Bank and Alliance Bank, the earnings performance of the remaining eight largest banks was below the industry average.

71. Table A4.4 in Appendix 4 groups banks into profitable, low-profit, loss-making, and restructured categories. In the first category, 10 banks held 35.0% of net loans outstanding and showed average return on equity of 16.6%, or greater than the rate of inflation and average return on total assets of 1.9%. The growth rate in net loans outstanding for the high earning group was 34% in 2011. The second group, low-medium earners, had a return on assets of 0.16% and return on equity of 1.20%. Loan growth was zero. This group held 34% of net loans outstanding.

72. Overall banks with asset growth funded it through borrowing and sundry liabilities (6%), deposits (78%), and equity and retained earnings (16%). This is a marked decrease in borrowing as a source of funds: in 2007, 33% of total assets had been funded by borrowing, 55% by deposits, and 12% by equity. There are substantial differences between the banks in their sources of funding. Five banks funded more than 100% of their increased assets through deposits, offset by declines in borrowing or net worth. Banks with large increases in deposits not matched by equity growth include Bank CenterCredit, TsesnaBank, and KazInvestBank.

5. Electronic Banking

73. As at 1 January 2012, 21 banks and Kazpost had issued 9,568,800 payment (credit/debit) cards to 8,855,400 people, an increase of 13% over the previous year. This indicates that more than 77% of adults held a payment card. Almaty and Astana, with 13% of the total population, accounted for 44% of payment card holders—one card per person. Card coverage declines markedly outside these two hubs. In the Kostanai, Akmola, Zhambyl, North Kazakhstan, South Kazakhstan and Almaty regions there is one card per 3.5 people.

74. By the end of 2011 there were 8,110 ATMs, up 7% over 12 months, and 28,597 point-of-sale outlets, up 10%. ATMs account for 89% of cash withdrawal transactions and point-of-sale outlets for 74% of cashless transactions. The average ATM withdrawal is T19,330 ($130) and the average cashless transaction was T32,290 ($218). In the last quarter of 2010, money payment orders were responsible for 25.2% by number and 92.6% by value of all payment transactions, compared with 72.3% by number and 2.9% by transaction value for credit cards.[42] The average value of a payment order was T2.3 million ($15,500).

75. Most banks offer internet banking services, but the uptake is minimal. It is estimated that total usage is around 200,000 customers, less than 10% of loan accounts. Kaspi Bank has one million cardholders. Since December 2011, the bank has provided a free mobile phone top-up service to 100,000 of its customers to allow service payments for their mobile phones through their Kaspi account. This saves on travel costs associated with mobile phone payments amounting to 5% to 15% of the cost of phone services. Kaspi Bank—aware of the success and potential for these services as M-Pesa demonstrated in Kenya—intends to develop more mobile-phone-linked banking services. Kazpost also intends to expand e-banking services and has initiated a project for this purpose. Its e-banking services are related mainly to pension, taxation, and municipal payments. Kazpost customer money transfers comprise only 2% of the

[42] A payment order is a method of payment and money transfer under which the sender gives instruction to the receiving bank to remit an amount of money specified in this instruction in favor of the beneficiary.

total market for this service. Technical support for the development of e-banking is considered unnecessary as interested parties are aware of market potential and proprietary interests are involved.

6. Islamic Banking

76. Islamic finance regulations were drafted and approved in February 2009 under the Islamic Finance Law.[43] These include preparation of financial statements and the bookkeeping procedure by Islamic special financial companies and Islamic banks, including adding new accounts to the standard chart of accounts required for Islamic entities to maintain their accounting. One Islamic bank, Al Hilal Islamic Bank, was issued a banking license in 2010 and set up as a 100% subsidiary of the Abu-Dhabi government-owned Al-Hilal Bank.[44] The bank has shown operating losses in each of the last two years and is under forfeiture of FSC to accept interest-free deposits at short notice of individuals and open banking accounts of individuals.[45] The Malaysian government-owned trustee company, Amanah Raya Berhad, is planning to establish the second Islamic Bank in the country in 2011–2012 as a joint venture with the Development Bank of Kazakhstan and local brokerage company Fattah Finance. This is yet to be confirmed.

77. In 2010, the Islamic Development Bank provided a $30 million, 10-year loan (with a 3-year grace period) to the state-owned KazAgroFinance to purchase farm equipment and, as the owner, lease the equipment out to farmers. The Islamic Development Bank first purchases the equipment and sells it at a markup to KazAgroFinance. The markup is in lieu of interest charged to KazAgroFinance.

78. In July 2011, the government approved the Law On Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Islamic Financing*,* which allows local issuance and placement of Islamic securities, known as *sukuk* bonds.[46] In July 2012, the Development Bank of Kazakhstan successfully priced its offering in Malaysian ringgit, of MYR240.0 million, of Malaysian domestic Islamic notes, with an annual coupon of 5.5% and a 5-year maturity. The groundbreaking offering, structured under the MYR1.5 billion Islamic Medium Term Note Programme under the sharia principle of *Murabaha*,using commodities as underlying assets, was the first sukuk issue out of the Commonwealth of Independent States.[47] It was also the first issue from the Central Eastern Europe/Commonwealth of Independent States to tap Malaysian ringgit. The central bank is implementing accounting regulations that are sharia compliant.

7. Leasing Activities

79. As noted, the Leasing Law of 2000 (amended in 2011) regulates leasing activities, which in 2009 amounted to 3% of aggregate bank lending, largely for agricultural equipment. In 2009,

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[43] The Law on Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Organization and Activity of Islamic Banks and Organization of Islamic Financing, of 2009.

[44] By resolution of the Committee for the Control and Supervision of the Financial Market and Financial Organizations (FSC) of the National Bank of Kazakhstan.on 5 August 2011, Al Hilal Islamic Bank forfeited its right to accept interest-free deposits on short notice of individuals opening banking accounts under its license to carry out the banking operations of an Islamic bank. The forfeiture is due to noncompliance with capital requirements.

[45] The board of the National Bank of Kazakhstan issued Decree № 90 dated 22 July 2011.

[46] *Sukuk* is an Islamic financial certificate, similar to a bond, that complies with sharia law.

[47] *Murabaha* is one of the most commonly used modes of Islamic financing, representing a sale in which the seller expressly mentions the cost of the sold commodity he has incurred and sells it to another person by adding some profit.

KazAgroFinance held 44% of the leasing market, Astana Leasing 20%, and DBK Leasing 14%, the former facing. A severe drought in 2009, that affected agricultural production, put strains on KazAgroFinance. In addition, many of the 46 registered leasing companies have common ownership with banks, and restructuring at some of the banks (notably BTA Bank and Alliance Bank) has affected leasing subsidiaries. The NBK neither regulates nor supervises leasing companies not affiliated to banks, nor does it provide data on the volume of lease contracts. Given the government's program of industrialization there are expectations that leasing will grow in tandem with the government plan, perhaps doubling in the next three years. Long-term financing is needed for the leasing industry to grow; Samruk-Kazyna is providing this to select leasing firms.

8. Banking Sector Concerns

80. Since the global financial crisis, banks have paid much more attention to risk management, better governance and financial reporting, and the adequacy of operating cash flow and loan collateral. As outlined above, some banks are developing new and profitable business models in micro and small enterprise lending and household financial services, including mobile banking and financial services such as insurance.

81. The following are concerns that are being addressed include or need to be:

(i) Soft funding arrangements and inadequate disclosure make it difficult to ascertain the ultimate user of public funds and evaluate their economic benefits. The government used public funds to counter the full impact of the global financial crisis. The problem of inadequate disclosure is exacerbated in affiliated firms, where full information on ownership is frequently unavailable. The investment of public funds in the restructuring of the three large banks and support provided to Halyk Bank and Kazkommertsbank is well documented. Halyk Bank can be said to have been a sound investment; it has good earnings performance and has fully repaid the support funding it received. However, providing support to a few select banks risks making it more difficult for better performing banks to compete and gain market share to reflect their efficiency.

(ii) Subsidized interest rates at the small end of the market—in particular for housing, micro and small enterprise development, and agriculture—hinder the development of efficient financial markets. Lending from DAMU, HCSB, Kazakhstan's Employment 2020 initiative, and the Fund for Financial Support of Agriculture—of around T126 billion ($855 million) at subsidized interest rates (5%–9% compared with the market rate of 19.5% or higher)—cuts into the development and expansion of efficient financial markets. In addition, these subsidized entities are unable to achieve substantial market outreach because their source of funding and pricing of risk is not market-related. The demand for cheap credit exceeds supply. KazAgroFinance and DBK Leasing combined hold 58% of the market.

(iii) Varied levels of IFRS implementation impact the accuracy and the comparability of banks financial reporting. This is related to the varied levels in the adoption of IFRS accounting and the classification and valuation of loans and accrued interest income. The analysis of financial statements in this report should therefore be regarded only as indicative. The banks themselves have yet to calculate the impact on their financial statements of the full adoption of IFRS.

(iv) Temporary taxation exemptions in relation to debt restructuring allow banks to provide favorable treatment to select borrowers. The exemption from income tax on the amount of decrease in loan loss provisions applies only to the 2012 calendar year. This amendment needs to be permanent or at least for 3–5 years beyond 2012–2013 to help the banks clean the balance sheets. Furthermore, it is not clear whether a loan write-off will be taxed as income in the hands of the borrower, even though the bank has not forgiven the borrower's debt. Any loan write-off or forgiveness should be treated as a capital flow and not taxed as income. Furthermore, the Ministry of Finance implies that the bank would inform the borrower of any loan write-off—this is contrary to good banking practice. A loan write-off does not necessarily release the borrower from the obligation to repay the loan; a separate legal procedure is required for this.

(v) An amendment applicable only to 2012 allowed banks to forgive borrower loans up to 10% of the amount of the bank's aggregate loan portfolio without the borrower or the bank being liable for tax on the amount of forgiveness.

(vi) The inadequacy of reporting of affiliated firms makes it difficult to assess the value of a subsidiary or parent firm and to determine the sources and uses of funds among the affiliated firms. This will be addressed through the new Law on Risk Minimization, which came into effect in early 2012.

B. The Microfinance Subsector

82. The government plans to achieve financial service coverage for all households. The major suppliers of microfinance services include banks, nonbank financial institutions such as Kazpost, mortgage companies and subsidiaries of the National Agricultural Holding Company, microcredit organizations, credit partnerships,[48] and insurance companies. Data indicate that banks hold 2.6 million loan accounts;[49] that Kazpost holds 1.5 million deposit accounts, mostly linked to pension payments and covering 44% of the market; that microcredit organizations hold 330,000 loan accounts; and that credit partnerships hold about 70,000 loan accounts (or 4.5 million accounts all together). And almost 75% of households have a loan account. But the NBK does not collect data on loan size, making it difficult to get accurate information on the number of microenterprises or number of recipients of microfinance services or on the outreach of services to rural versus urban households. This section focuses on financial institutions capable of improving service outreach, including through loans, deposits, money transfers, access to funds, and insurance services.

1. Volume of Microcredit

83. Microcredit organizations and credit partnerships are major suppliers of microcredit. From 2007 to 2011, a substantial 1,011 new microcredit organizations were registered, but the net increase was only 275: nearly 73% of the newly registered microcredit organizations did not survive the financial crisis (Table 8). As with the banks, there was an increase in loan size until 2008, followed by a decline in loan size and number of borrowers.[50] Since 2009, there has been

[48] This list focuses on institutions that provide a large part of their services to businesses, and so excludes 78 pawnshops.
[49] Based on an average loan size of T4 million ($27,000).
[50] Data on the numbers of borrowers are not reliable and are only indicative: frequently microcredit organizations quote cumulative rather than active borrowers in their numbers, and there has been no audit verifying these numbers.

an increase in number of borrowers, which has continued into 2012. The average loan size in 2011 was similar to that in 2007, indicating that microcredit organizations are still focusing on microlending. Meanwhile, female borrowers declined from more than 60% of the total in 2008–2009 to 44% in 2011, which could indicate under-employment among men who are then turning to microcredit organizations for microbusiness loans; it could also be the result of the reluctance of banks to expand their microloan portfolios—with two exceptions as outlined below. Total microcredit organization lending amounts to 0.7% of bank lending. In reality, however, it is even less as some microcredit organization lending is financed by banks.

Table 8: Outreach of Microcredit Organizations

Category	2007	2008	2009	2010	2011	2012
Registered microcredit organizations	745	1,086	1,317	1,712	1,780	1,756
Operating microcredit organizations	697	948	1,088	1,375	1,173	972
Loans outstanding (tenge million)	56,083	32,412	40,844	55,366	104,796	77,800
Loans outstanding ($ million)	460	269	278	376	713	521
Total borrowers (number)	336,636	170,981	197,448	378,589	486,082	228,453
Average loan balance/borrower ($)	1,366	1,573	1,407	994	1,466	2,282
Female borrowers (% of total)	...	60	68	44	...	...

... = not available.
Sources: Association of Microfinance Organizations of Kazakhstan (AMFOT). 2013. *Microfinance in the Republic of Kazakhstan.* Almaty: AMFOT; National Bank of Kazakhstan. http://www.nationalbank.kz/?docid=158.

84. By the end of 2011, 41 AMFOK member microcredit organizations (of 699) had 243,320 borrowers, for an average of more than 5,900 borrowers per organization and an average loan size of $1,680. The remaining 658 non-AMFOK organizations surveyed had 87,390 borrowers for an average of 132 per organization, with an average loan size of less than $350. Most of the non-AMFOK organizations are insignificant in size and operate in a single location.[51]

85. Table 8 does not include microlending through the 89 credit partnerships registered by the Justice Ministry and for which there is no information on number of borrowers or of volume of lending. Many credit partnerships operate in rural areas and some have funding arrangements with the state-owned National Agricultural Holding Company. These rural credit partnerships lend to larger farming units. ORDA Credit, a large, urban-based credit partnership in Shymkent, which publishes data, had a loan portfolio in 2010 of $22.5 million and 3,280 borrowers with an average loan balance of $6,850. There is no effective system of monitoring and supervision of credit partnerships. Given their legal right to take in deposits from nominal members, their larger loan size, and potential for rural lending, it is recommended that the central bank license and supervise credit partnerships.

86. Table 8 also does not include activities associated with the Employment 2020 program, which, since June 2011, has provided loans of up to $20,000 to prospective entrepreneurs; $80 million has been allocated to this pilot program, which now has 1,400 borrowers. Loans are for 54 months at 5% interest, including a 12-month grace period.

87. In 2008, it was estimated that banks had 28,400 microcredit borrowers in a total loan portfolio of $52.4 million and an average loan balance of $1,850.0.[52] But unlike the microcredit

[51] DAMU has an average 22% shareholding, totaling $310,000, in six microcredit organizations that are not AMFOK members.
[52] Frankfurt School of Finance & Management. 2008. *Microfinance Diagnostic Study*. Frankfurt am Main. Germany.

organizations, much of this lending was for household consumer items, including car purchases, rather than microenterprise investment. No standard definition exists for a microcredit loan size: one bank stated microcredit loans were those below $100,000 and another below $50,000. Some banks use an arbitrary figure of $10,000. For reporting banks in 2008 (including BTA Bank and Temirbank) the aggregate number of micro-borrowers, due to the financial crisis, is unlikely to have increased in the last three years. Kaspi Bank has become active in retail lending and now has 1.3 million borrowers. Deducting large loans to corporate customers, small and medium enterprise loans to 8,000 borrowers, and household consumer loans (about 50% of the total loan portfolio with an average balance of $1,000), would indicate Kaspi Bank has around 90,000 microenterprise borrowers based on average loan size of $4,000. In 2011, Eurasian Bank took over Prosto Kredit, which was the largest microcredit organization at that time. There is therefore interest among some banks in the development and promotion of microfinance services.

2. Legislation for Microfinance Institutions

88. At present, the FSC does not regulate credit partnerships and microcredit organizations, and they are not considered part of the banking sector. Two laws on microfinance and credit partnerships enacted in 2003 cover these institutions.[53] Microcredit organizations are not allowed to take deposits and cannot be joint stock companies—many are founder limited liability partnerships. The NBK, with industry participation, worked on the Law on Microfinance Organizations adopted in October 2012.[54] Microcredit organizations, except nonprofit microcredit organizations, are subject to state re-registration in accordance with this law till 1 January 2016. The new regulation caps annual interest rates the microfinance institutions charge at 56% and requires all to hold account records at the NBK. The minimum charter capital for each institution has been set at T30 million ($198,000). The new law allows microfinance institutions to act as agents for insurance companies in the selling of policies and collection of premiums. This will see the creation of health and accident policies linked to loan agreements that will provide better financial and social protection for borrowers and their families. The continued prohibition on deposit taking may constrain the development of e-banking in microfinance institutions, although they will be able to develop e-banking for loan repayments.

89. The law brings a number of advantages. The NBK's supervision of microfinance institutions will encourage the orderly development of services and provide information on microfinance institutions that could lead to a broader range of allowed financial services, including deposit taking. The capital requirement will curb the proliferation of microfinance institutions.[55] The ability to act as insurance agents will allow microfinance institutions to provide additional and valuable financial services while making their outlets more cost-effective. But there will need to be a trade-off between more intensive and costly supervision of microfinance institutions and merely monitoring microfinance institutions, particularly the smaller ones.

3. Microcredit Organization Performance Review

90. A financial review of four microcredit organizations—KazMicroFinance, the Asian Credit Fund, the Fund for Financial Support of Agriculture, and ORDA Credit (a credit partnership)—indicates the strengths and weaknesses of the subsector.

[53] The 2003 Law on Microcredit Organizations (which became invalid with the adoption of the Law on Microfinance Organizations), and the 2003 Law On Credit Partnerships.

[54] A roundtable involving government and microcredit organizations in March 2012 discussed provisions in the law.

[55] One observer commented that the number of operating microcredit organizations could decline to around 100, from more than 900 now.

91. KazMicroFinance in 2010 had $36.5 million in loans outstanding and 30,700 borrowers, of whom 73% were women (Appendix 4, Table A4.5), with an average loan balance of $1,200. The loan portfolio declined and expenses increased to 92% of revenues because of the global financial crisis in 2008. While 2010 was a year of recovery, indicators for 2011 show it to have been a temporary reprieve. The expenses-to-revenue ratio was 80% in 2011, return on equity 19%, and the capital adequacy ratio was around 30%. Loan revenue was 44% of average loans outstanding in 2011; nonperforming loans of greater than 30 days were 2.9%, and 2011 saw substantial growth in lending that was likely repeated in 2012, though hard numbers are as yet unavailable. Lending increased by 40% in 2011 to reach a loan portfolio of $51 million and 45,800 borrowers. Agricultural lending is 20% of the loan portfolio and 25% of borrowers are rural. KazMicroFinance has been relatively stable in performance due to a sound operating system and international financial institutions' financial support (KazMicroFinance is supported by five). The data show the feasibility of providing microcredit in a financially sustainable manner.

92. The Asian Credit Fund—fourth largest microcredit organization by number of borrowers—in 2010 had a loan portfolio of $2.6 million, with 4,500 borrowers (99% women) with an average balance of $580.0 (Appendix 4, Table A4.6). The global financial crisis saw a large reduction in its loan portfolio in 2008, accompanied by a reduction in borrowing. Since 2008, international financial institution borrowing has enabled the fund to increase its loan portfolio and finance continuing operating losses. Return on equity is negative, loan revenue is 61.0% of average loans outstanding, nonperforming loans of greater than 30 days is 6.3%, and the capital adequacy ratio stands at 14.0%. Oikocredit and Mercy Corps provide the Asian Credit Fund financial support.

93. The Fund for Financial Support of Agriculture is a state-owned, closed joint stock company (Appendix 4, Table A4.7). Loans outstanding were $70 million to 18,500 borrowers in 2010, 34% of them women. The average loan balance is $3,800 and nonperforming loans greater than 30 days is 13.1%, with nonperforming loans greater than 180 days at 9.2%. The fund enjoys low cost and growing funding, with an average cost of funds of 4.9%. Loan revenue on average loans outstanding is 10.4%, and its return on equity is 1.9%, well below the average inflation rate of 7.8% during 2010.[56]

94. ORDA Credit in 2010 had $22.4 million in loans outstanding to 3,280 borrowers (68% women), with an average balance of $6,800 (Table A4.8). This typifies the higher loan size observed in credit partnerships. Nonperforming loans greater than 30 days were 3.29% in 2010, expenses-to-revenue ratio 68.00%, and return on equity 10.50%. Loan revenue was 19.7% on average loans outstanding, and operating costs were 5.8% of average loans outstanding. The figures indicate a well-performing credit cooperative.

95. KazMicroFinance, the Asian Credit Fund, the Fund for Financial Support of Agriculture, and ORDA Credit demonstrate

(i) the ability of private sector microcredit organizations to earn satisfactory return on equity to attract equity capital;

[56] The Agrarian Credit Corporation also provides loans at 4% interest to almost 150 rural credit partnerships for onlending to farm enterprises, with an interest rate capped at 9%. Similar loans are also provided to rural consumer cooperatives. KazAgroFinance provides loans and leasing services to agro-industrial firms. These two institutions, along with the Fund for Financial Support of Agriculture, are subsidiaries of the government-owned National Agricultural Holding.

(ii) that among private sector microcredit organizations, nonperforming loans are much lower than for banks and government-owned financial institutions;
(iii) the high coverage of female borrowers; and
(iv) an ability to recover from the financial crisis.

96. In summary, the microfinance sector is underdeveloped and almost insignificant in size compared with the banking sector or GDP. Characteristics of the sector include

(i) a lack of interest among most banks in making microloans—especially less than $5,000 in size;
(ii) a large number of small, unsustainable microcredit organizations with financial reporting that is below international standards;
(iii) a lack of oversight to ensure the compliance of microcredit organizations with accounting standards and timeliness of reports (to be addressed by the adopted Law on Microfinance Organizations;
(iv) relatively few (less than 40) large microcredit organizations are responsible for more than 80% of microcredit by volume and number of borrowers;
(v) a reliance on borrowing and/or share capital as sources of funds is limiting the growth of microcredit organizations; and
(vi) government provides below market-cost funding of rural and agricultural microcredit organizations (also called nonbank financial institutions), which unfairly compete with market-oriented microcredit organizations.

C. Banking Sector Roadmap for Technical Assistance

97. To further develop the banking sector and the microfinance services subsector, technical assistance targeting government agencies and staff is proposed to improve the disclosure of information, the improvement of the business environment, and the improvement of the outreach of microfinance services. Scope may also exist to include key staff of financial institutions in the development of legislation, procedures, workshops, and training.

1. Improve Disclosure of Information

98. The Law on Risk Minimization will be applied to banks and their affiliated companies through the National Bank of Kazakhstan Department of Surveillance and Control Methodology. The law will

- improve the supervision of bank conglomerates,
- introduce greater transparency in the activities and sources of capital of financial institutions,
- improve corporate governance in financial institutions and joint stock companies,
- ensure more timely and accurate disclosure of information,
- improve legal mechanisms for restructuring of banks within bank conglomerates,
- update procedures for the restructuring of liabilities,
- raise bank supervision and regulation to international standards, and
- establish an effective system for the protection of investor rights to raise investor confidence in the securities market and develop accumulative pension fund and investment fund operations.

99. The scope of work for this department is vast and challenging. Support in establishing and piloting methodologies and procedures and the evaluation of these would be useful.

100. The technical assistance will help improve disclosure of information in financial institutions through three outputs: (i) a review and evaluation of governance and financial reporting, (ii) improved procedures and reporting formats for the accounting and analysis of intercompany transactions, and (ii) the provision of up-to-date training and training materials for regulators. The technical assistance activities will be sequenced as per the below.

Output 1: Review and evaluate governance and financial reporting.

(i) Assess the present system(s) of accounting and relationships among a sample of affiliated firms.
(ii) Outline concerns that need to be addressed and establish a schedule of activities and actions to be taken.
(iii) Assess assets and liabilities within each of the affiliates, and provide an assessment of risks within each affiliate, including for the consolidated group as a whole.

Output 2: Improve procedures and reporting formats for the accounting and analysis of intercompany transactions.

(i) Set out the procedures for the evaluation of governance and internal controls, including management of risk, within affiliates and the consolidated group.
(ii) Set out reporting formats for affiliated firms as considered appropriate.
(iii) Develop operating manuals for central bank staff outlining their duties in identifying and assessing risk and ensuring compliance of firms with governance, internal control, and transparency requirements.
(iv) Strengthen computerized models within the central bank to better to assess the effect of identifiable risks on firms and their affiliates and their impact on the banking sector.

Output 3: Provide up-to-date training and training materials for regulators.

(i) Train central bank staff in the evaluation of governance and internal controls within the supervised firms and deciding on actions to be taken for their improvement.
(ii) Conduct seminars, workshops, and training courses for central bank staff and staff of supervised institutions that would cover risk identification and management, governance and internal controls, and improved accounting systems especially for conglomerates.
(iii) Improve the structure and content of training course materials.

2. Improved Business Environment

101. Many defunct businesses have been stripped of assets, making a claim against them by creditors almost worthless. Many borrowers also face insurmountable debt that will shut-down their businesses or at least severely constrain or prevent business growth. Large businesses are receiving professional assistance in debt and business restructuring, but small businesses are not. The Law on Bankruptcy is being amended to facilitate the liquidation or rehabilitation of businesses and households, but details of the amendments are unclear. The proposed technical assistance would work closely with the Ministry of Justice, Ministry of Economic Development and Trade, the Ministry of Finance, and DAMU.

102. The technical assistance would be expected to improve the business environment and encourage entrepreneurship while protecting creditors. Its two outputs would include advising the government on the procedures and legislation for debt resolution and delivering up-to-date training for regulators, DAMU, and financial institutions in the debt analysis and restructuring of small and medium enterprises. The sequence is outlined below.

Output 1: Provide advice on procedures for debt resolution.

(i) Review the Bankruptcy Law and its amendments and hold discussions with government, financial institutions, and DAMU on ways to facilitate debt resolution processes envisaged under the law.
(ii) Advise government on legislative amendments that could improve debt resolution and assist in developing appropriate regulations, instructions, and procedures that debtors and their creditors would follow.

Output 2: Strengthen the capacity of regulators, financial institutions, and DAMU in debt resolution.

(i) Provide advice and training to DAMU on debt analysis and restructuring of small and medium enterprises.
(ii) Assist DAMU in the development of advisory materials for the assessment of excessive debt within small and medium enterprises.
(iii) Provide recommendations that DAMU could make for the rehabilitation of such small and medium enterprises in financial difficulty.
(iv) Develop and deliver training materials and workshops for debt resolution for government agencies, DAMU, and financial institutions.

3. Improved Outreach of Microfinance Services

103. The outreach of financial services in rural areas is weaker than in cities. This presents a challenge in providing a broad range of cost-effective financial services to rural areas, where the volume and size of financial transactions tend to be small and therefore relatively expensive to users and suppliers of services. The rural market is 1.6 million households engaged in farming, microenterprise, and household activities. The range of services includes lending, savings, cash withdrawals and payments, money transfers including social benefits, state and local taxes, and insurance products.

Rapid growth in e-banking is also changing financial service methodology, leaving previous methods of service delivery outmoded or requiring substantive change to remain cost-effective. This report has identified microfinance service suppliers such as banks, microcredit organizations, credit partnerships and mobile network operators. More information is required to assess the best way to provide different types of services and links among services to avoid the support of inefficient and ultimately obsolete service suppliers.

104. The technical assistance would be expected to improve the outreach of microfinance services, especially among rural and poor households, with a broad range of cost-effective financial services. It would identify consumer needs for microfinance services, ensure no undue legislative barriers constrain the supply of broadly needed microfinance services, strengthen on- and off-site supervision of microcredit organizations and credit partnerships, and improve the financial literacy of users of microfinance services.

Output I: Identify consumer needs for microfinance services.

(i) Design, implement, and evaluate a survey of the microfinance services rural and urban households, microenterprises, and farmers need.
(ii) Help the NBK, Ministry of Labor and Social Protection, and the Ministry of Economic Development and Trade develop a roadmap for a comprehensive and attractive range of financial services to rural and urban households, microenterprises, and farmers.

Output 2: Review and advise on the legislation affecting the supply of microfinance services.

(i) Work with government agencies and financial service suppliers to assess microfinance services that can be provided in a feasible and cost-effective manner.
(ii) Review the legislation affecting existing and feasible microfinance services and advise on suitable amendments.

Output 3. Strengthen on- and off-site supervision and monitoring of microcredit organizations and credit partnerships by helping the NBK to:

(i) develop appropriate systems for monitoring the supply and use of microfinance services through banks, insurance firms, microcredit organizations, and credit partnerships, including the content, frequency, and mode of reporting;
(ii) rationalize a selection process of microcredit organizations and credit partnerships that would be subject to a cost-effective system of on-site and off-site supervision and assist the central bank in developing the required supervisory procedures through training and the development of operational manuals and reporting standards; and
(iii) draft regulations as required for the licensing, monitoring, and supervision of microcredit organizations and credit partnerships.

Output 4: Improve the outreach of financial literacy training and extension among microfinance service users.

(i) Review the financial literacy materials prepared by the Committee for the Regional Financial Center Almaty and recommend ways to use and adapt these materials to expand knowledge among enterprises and households.

Table 9: Recommended Technical Assistance for the Banking Sector: Outcomes and Outputs

Outcomes of Each Technical Assistance	Outputs of Each Technical Assistance
1. Improved disclosure of information by affiliated firms.	• Review and evaluate governance and financial reporting. • Improve procedures and reporting formats for the accounting and analysis of intercompany transactions. • Provide up-to-date training and training materials for regulators.
2. Improved business environment that encourages entrepreneurship while protecting creditors.	• Advise government on procedures and legislation for debt resolution. • Deliver up-to-date training for regulators, DAMU, and financial institutions in the debt analysis and restructuring of small and medium enterprises.
3. Improved outreach of microfinance services, especially among rural and poor households, with a broad range of cost-effective financial services.	• Identify consumer needs for microfinance services. • Review and advise on legislation affecting the supply of microfinance services. • Strengthen on- and off-site supervision and monitoring of microcredit organizations and credit partnerships. • Improve the outreach of financial literacy training and extension among microfinance service users.

Source: Frankfurt School of Finance & Management.

D. Insurance Sector

1. Market Overview

105. Kazakhstan's is the third largest insurance market in the Commonwealth of Independent States, behind the Russian Federation and the Ukraine.[57] It ranks 68th in the world on premium rankings, while the gross written premium of 35 insurance companies was T237,143.23 million ($1.57 billion) in 2012, compared with $950.00 million in 2010.[58] Its share of the world market is 0.02%.[59] Kazakhstan's insurance industry grew 12.9% in 2011 by asset size—admittedly off a very low base—and industry experts expect it to grow another 10%–15% to a market of up to $1 billion in the years ahead.[60] Premium growth can be attributed to government-initiated reforms and sound economic growth. The growing economy, supported by its relative stability and booming energy sector, has boosted per-capita incomes, raising demand property, automobiles, and other nonfood categories. As standards of living have increased, the development of social insurance for the underprivileged has helped drive the insurance segment.

106. In total, the 38 licensed insurance (reinsurance) companies (as of 01 January 2013) included seven life insurers (including accident insurance) and 31 nonlife insurers (including

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[57] The finance sector as a whole is dominated by the banking sector, which accounts for 85% of overall financial services. Insurance, private equity, leasing, and microfinance represent the rest.

[58] Swiss Reinsurance Company. 2011. *World Insurance in 2010: Premiums Back Growth – Capital Increase*. No 2/2011. Zurich: Swiss Reinsurance Company.

[59] Swiss Reinsurance Company. 2011. *World Insurance in 2010: Premiums Back Growth – Capital Increase*. No 2/2011. Zurich: Swiss Reinsurance Company.

[60] U.S. Commercial Service. 2011. "An Expert's View of Banking, Finance and Insurance in Kazakhstan." http://www.globaltrade.net/f/market-research/text/Kazakhstan/Banking-Finance-and-Insurance-Insurance-Sector.html

health and accident insurance). Foreign companies own four insurance companies and the state two (State Annuity Company and KazExportGarant).

107. There are also more than 40 mutual assistance associations, which are not subject to licensing or regulatory or supervisory requirements and only need to be notified by the central bank.[61] They operate under Mutual Insurance Law and Cooperative Insurance Law and are mainly involved in plant and cultivation insurance. Crop insurance premiums are not sufficient to cover losses by the mutual assistance companies. This approach has caused problems and disputes between the insurance companies and farmers.

108. Of the gross written premium:

- voluntary nonlife insurance purchases contributed 50.24% (accident 7.67%, sickness 6.98%, property insurance 19.75%, motor hull 2.84%, aviation 1.09%, cargo 1.91%, general third party liability 5.10%, and financial losses 5.99%);
- compulsory insurance contributed 22.72% (motor third party liability 11.78% and worker's accident 10.94%); and
- life insurance contributed 22.12% (71.33% of the life portfolio comprises of annuities).[62]

109. The figures indicate that premiums are growing, but only because of rising nominal GDP. The concentration of highly profitable corporate insurance and obligatory insurance of individuals has led to non-diversification of voluntary retail insurance services provided by local insurance companies. Further development of voluntary retail insurance is perceived as a costly activity for these insurance companies. This can be attributed to two major changes in insurance laws. First, the new Law on Mandatory Insurance of Employees against Workplace Accidents, of January 2012, only permitted life insurance companies to engage in this class of mandatory insurance. The nonlife insurance companies were allowed reinsure risks for this class. The main idea of the innovation was to avoid a conflict of interest between life and nonlife insurance companies in claims payment. Second, in May 2012, new reinsurance rules were introduced under which insurers will cede up to 75% of risks to a domestic reinsurer and rating requirements for foreign reinsurers were increased. The measure aimed to increase domestic risk retention, as well as to ensure that reinsurance premiums ceded overseas are with reinsurers with sound ratings.

110. Individual regulatory acts govern mandatory insurance, and the maximum claims settlement period is 7 days. But despite the growth of premiums on the third party liability insurance of vehicle owners, paid claims have not increased significantly, leading many to conclude that insurers are reluctant to fulfill their obligations to customers.[63] Introduction of a uniform template to report damages due to road accidents is currently on the Kazakhstan insurance markets' agenda. Under discussion is the establishment of a common assessment methodology for assessing losses arising out of an insured vehicle and a common reporting template for drivers. For voluntary insurance, the claim settlement period is governed primarily by (dispositive) optional provisions, that is, legal requirements may be altered upon agreement between the parties. However, the central bank also has the authority required to supervise and

[61] With the abolition of the Agency of the Republic of Kazakhstan on the regulation and supervision of financial market and financial organizations in 2011, the FSC was formed in April of that year.

[62] *Xprimm.com.* 2012. Fiscal year 2012 Market Portfolio. http://www.xprimm.com/statistics/CEE-OVERALL-MARKET-DATA-FY2012.xlsx.

[63] *Xprimm.com.* 2012. The Market Entered "the First Billion Euro" Area. http://www.xprimm.com/KAZAKHSTAN-2011-The-market-entered-the-first-billion-euro-area-articol-2,12,32-1522.htm.

control the conclusion and fulfillment of insurance contracts that prevent insurance companies from abusing and violating the interests of their clients.

Table 10: Insurance Market Portfolio

Business line	**Gross Written Premiums**			**Paid Claims**			**Weight in All Gross Written Premium**	
	2012	**2011**	**Change** (%)	**2012**	**2011**	**Change** (%)	**2012** (%)	**2011** (%)
Total market	**237,143.23**	**198,503.34**	**19.47**	**75,697.24**	**46,139.25**	**64.06**	**100**	**100**
Total life	**52,440.48**	**30,478.83**	**72.06**	**29,444.98**	**14,041.37**	**109.70**	**22.11**	**15.35**
Life insurance (v)	15,023.39	6,473.35	132.08	450.95	244.50	84.43	6.34	3.26
Annuity (v)	37,417.09	24,005.48	55.87	28,994.03	13,796.86	110.15	15.78	12.09
Total nonlife	**184,702.75**	**168,024.51**	**9.93**	**46,252.27**	**32,097.88**	**44.10**	**77.89**	**84.65**
Accidents (v)	18,185.22	11,476.64	58.45	883.65	527.84	67.41	7.67	5.78
Sickness (v)	16,548.45	12,402.73	33.43	10,811.60	9,001.20	20.11	6.98	6.25
Property insurance (v)	46,846.23	46,450.78	0.85	12,222.54	2,074.87	489.07	19.75	23.40
Overall motor insurance	**34,660.82**	**31,789.38**	**9.03**	**11,154.79**	**8,648.63**	**28.98**	**14.62**	**16.01**
Motor hull (v)	6,736.36	4,275.19	57.57	1,842.09	1,476.42	24.77	2.84	2.15
MTPL (c)	27,924.46	27,514.19	1.49	9,312.69	7,172.21	29.84	11.78	13.86
CARGO (v)	4,518.16	5,276.82	-14.38	365.51	422.89	-13.57	1.91	2.66
GTPL (v)	12,091.31	15,410.05	-21.54	1,868.57	496.38	276.44	5.10	7.76
Financial losses (v)	14,216.67	10,937.02	29.99	49.68	4,298.02	-98.84	**5.99**	**5.51**
Worker against accidents (c)	25,954.36	22,600.31	14.84	7,059.39	5,428.76	30.04	**10.94**	**11.39**
Others (c) + (v)	11,681.54	11,680.79	0.01	1,836.54	1,199.29	53.14	**4.93**	**5.88**

c = compulsory insurance, GTPL = general third party liability, MTPL = motor third party liability, v = voluntary insurance.
Source: Xprimm.com. Market Portfolio. http://www.xprimm.com/Kazakhstan-2,12,32-20.htm

Table 11: Insurance Premiums and Claims Payments per Type of Activity (tenge '000)

	2011		2012	
	Premium	**Claims**	**Premium**	**Claims**
Agriculture, hunting, and forestry	1,815,659	284,886	2,107,080	1,003,075
Fishery, fish breeding	29,959	190	27,696	874
Mineral resource industry	36,697,858	5,716,289	26,244,993	6,144,204
Manufacturing industry	14,969,006	5,902,633	14,980,940	3,885,890
Production and distribution of electrical energy, gas, and water	2,326,251	310,117	6,191,193	334,291
Construction	6,600,929	858,471	7,310,993	2,051,742
Trade and maintenance of automobiles and consumer goods	7,250,834	999,503	7,595,045	5,610,151
Hotels and restaurants	342,420	14,320	307,124	17,721
Transport and communications	11,634,368	1,639,899	12,682,068	2,146,167
Financing activities	4,046,389	1,761,498	5,461,093	2,105,201
Real estate activities, rent, and services to consumers	10,651,434	1,588,690	12,984,742	2,818,096
Public administration	1,321,497	157,704	1,199,311	430,334
Education	445,914	91,447	521,025	109,976
Health care and social services	525,510	474,936	773,003	1,045,091
Public, social, and personal services	2,744,135	775,575	3,345,698	1,259,914
Household producing goods and services for own needs	102,325	7,138	467,860	20,310
Activities of exterritorial organizations	495,951	53,007	406,048	56,011
For reference: natural persons	73,528,291	22,502,843	108,907,193	39,011,843
Total	**175,528,730**	**43,139,146**	**211,513,105**	**68,050,891**

Source: Financial Supervision Agency. 2013. "Insurance Sector. Total Statement on Classification of Premiums and Claims by Types of Economic Activity." Almaty. http://www.afn.kz/?docid=593 (Excel documents).

111. Nonlife Insurance. Opportunities for nonlife insurers are to a large extent linked to Kazakhstan's energy industry. Kazakhstan is a unique case of an underdeveloped nonlife market where motor insurance-related lines are not dominant. The nonlife segment is dominated by voluntary property insurance rather than compulsory motor insurance. The premium for voluntary car insurance, which is normally the first line to develop in an emerging insurance market, is surprisingly small. It is also dominated by a small number of local insurers that are tiny by international standards and primarily involved in underwriting property. Multinational insurers are thin on the ground, which is evidence that the business environment and the regulatory regime represent a significant barrier to entry.[64] A lot of the risk in this market is being ceded with reinsurers outside the country and the new reinsurance rules introduced in May 2012 is expected to reverse this trend.

112. Life Insurance. As is the case with other Commonwealth of Independent States countries, the core issues for the development of life insurance remain locked in the past. Life insurance remains grossly underdeveloped and accounts for slightly over 22% share of the domestic insurance market. This is compounded by a low standard of living, weak financial literacy, a lax attitude,[65] and a low level of confidence[66] in the insurance industry, reducing

[64] A case in point is that the global players, including the major Austrian firms, are absent. So, too, are the enormous insurers based in Asia and the Pacific which are, over the long-term, potential buyers of Kazakhstan's energy (especially the PRC). It appears likely to remain the case that most of the larger players in Kazakhstan will continue doing business with the energy sector and, in some cases, in effect, remain captive insurers.

[65] Kazakhstan Insurance Industry Overview Intelligence. 2010. Koncept Analytics.

incentives for making long-term savings for the safety of self and family through local financial institutions. Moreover, social protection and insurance systems sustain minimum functions that are increasingly insufficient considering rising price indexes for daily subsistence.[67]

113. The life segment is dominated by pension and disability annuities, and remains marginal by most measures. The accumulative pension funds' low level of assets of and virtually zero growth highlight this.[68] This can be attributed to the inadequacy of domestic investment opportunity as well as the high probability of random variability in mortality rates because of small annuitant pools.

114. The pension and annuity business is developing rapidly and its contribution to the growth of life insurance segment is 45%. Reinsurers provide mortality data, as insurers do not have their own data due to short history of operations. Payouts are increasing at 120% a year.[69] These developments demonstrate that there is growing interest, albeit extremely limited, in whole life annuities among current retirees, and there are companies willing to take on inordinate risks to do the business. In the absence of competition, this can result in accumulation of annuity risks by a small number of private life insurance companies with adverse long-term consequences. Another contributor to the rapid growth of the annuity business in last couple of years is pension annuities arising out of the transfer of pension savings from pension funds to life insurance companies.

115. Three life insurance companies practice classical life insurance: BTA Life, Kazkom Life, and General Life. Other life insurers are engaged in annuity insurance and mandatory workmen accident insurance. Most of the life insurers have been established as subsidiaries of banks as a requirement for loan disbursement. ProstoCredit Bank and HomeCredit Bank are the most active in the retail segment.

116. The insurance law allows a grace period up to 1 month for the payment of renewal premium with no extra charge. In the event of the lapsing of a life insurance policy or discontinuation in payment of regular premium, only a small portion of the premium paid is reimbursed as surrender value in cash provided that the premium has been paid for 2 years in continuation.

117. Health insurance. Health insurance premiums are only 3% of total premiums. Currently, there is only one voluntary health insurance product, and virtually all insurers are offering it.[70] About 200,000 people are covered under health insurance. Health insurance covers cost of dental services, out-patient and in-patient treatments, and medicines. Insurance contracts covering a wider range of services—from emergency medical care to providing the opportunity for spa treatments, dental care and medicines—are also available. The average annual premium is $250 and average coverage is $5,000. Age limits range from 1 to 65, although there are special programs covering infants below 1 year and elderly above and 65 years. These policies are not popular due to their high cost. Moreover, when diseases such as tuberculosis,

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[66] Low disposable incomes and the lack of trust among the general population for insurance companies is yet another factor hindering the development of the personal insurance lines market in the region. The poor claims payment record of many local insurers alongside old memories of the Soviet insurance organizations such as Gosstrakh and Ingostrakh (which were perceived as a form of government tax agent in insurance disguise) presents a major obstacle to the expansion of the private lines market. Similar findings are observed in the Recommendations for the State Annuity Company and the Kazakhstan Life Insurance and Annuity Market. USAID. November 2005.

[67] European Community Regional Strategy Paper for Assistance to Central Asia for the period 2007–2013.

[68] Business Monitor International. 2009. *Kazakhstan Insurance Report 2009*.

[69] Business Monitor International. 2011. *Kazakhstan Insurance Report 2011*.

[70] Both life and nonlife insurance companies can underwrite health insurance.

HIV/AIDS, and cancer are detected, the cover is cancelled. Medical insurance for overseas travelers is also sold and it covers treatment up to $50,000.

118. Insurance companies are working together to develop a universal concept of compulsory health insurance that will reach all consumers, including the socially vulnerable, such as unemployed mothers and pensioners in remote villages and in cities. This is expected to have positive impact on the health system and insurance sector. But one important concern is the insurers' current capitalization and its adequacy for such large social projects. Determining the cost of insurance to ensure the profitability of operations while making health insurance accessible is also a challenge. The president asked that the government submit proposals for the development of health systems, and insurers are expected to submit proposals for compulsory health insurance in due course.[71] It is assumed that the new model will be similar to the pension system in terms of assessment.

119. Disaster insurance. Residential property is not insured against natural disasters, and government compensates rehabilitation and recovery-related expenses. Corporations usually buy insurance and reinsure from abroad due to the significant risks involved. Catastrophic insurance does not exist in pure form.[72] Property might be insured against fire but not earthquakes. Most insurers in the market have no reliable quantitative estimates of their peak risk exposures (the probable maximal loss for given return periods), leaving them financially vulnerable to catastrophic events.

120. Despite the rapid growth of the property segment of the nonlife insurance market, and the recognized vulnerability of Kazakhstan to the risk of earthquakes and floods, few insurance companies would buy catastrophe excess-of-loss reinsurance protection. This leaves them vulnerable to substantial losses if even a single reinsurer defaults and at risk of failing to pay on their own policies after an earthquake of any serious magnitude.[73]

Table 12: Potential for Natural Disaster Insurance of Households (2010)

Population	Average Number per Household	Insurable Dwellings Countrywide	Insured Dwellings with Earthquake Cover Countrywide	Insured Dwellings with Earthquake Cover in Almaty	Exposed Dwellings Countrywide	Exposed Dwellings in Almaty
15,522,400	3.4	4,565,412	82,177	65,742	76,425	61,140

Note: Exposure estimated based on available market statistics and project results.
Source: The Financial Sector Strengthening and Reform Initiative. 2010. Kazakhstan: Reinsurance Regulation. http://www.firstinitiative.org/content/index.cfm?ctID=75.

121. In 2009, the United Nations International Strategy for Disaster Reduction and the World Bank, in a study of catastrophe risk financing options for mitigating the adverse financial effects of natural hazards on the economies of Central Asia, observed that over 99% of households and businesses remain uninsured against natural hazards and governments are fiscally ill-prepared to face economic losses from large catastrophic events. Despite severe exposure to natural hazards, catastrophe insurance coverage of the assets of individuals and small

[71] The first attempt to introduce compulsory medical insurance was in 1996, when the government established the Mandatory Health Insurance Fund to provide necessary medical care. But the fund was found to have large financial irregularities after a couple years and was no longer able to implement its contractual obligations to the suppliers of medical services.

A category of insurance in which the operation of an insured peril (catastrophe), such as an earthquake, results only in a loss and the occurrence of related event/s is beyond the risk-taker's control.

[73] The Financial Sector Strengthening and Reform Initiative. 2010. *Kazakhstan's Reinsurance Regulation*. http://www.firstinitiative.org/content/index.cfm?ctID=75

businesses is virtually non-existent. In addition, because of the small size of the catastrophe insurance premium insurers collect, some insurance companies find it difficult to find reinsurance protection, while retaining more catastrophe risk is not a preferred option. This may prevent companies from marketing catastrophe insurance coverage more aggressively. The lack of effective insurance supervision, coupled with competition for new business, result in premium rate discounting for all-risk property coverage to the detriment of customers. This compromises the placement of reinsurance protection with credible reinsurance companies and undermines insurers' ability to pay claims after a catastrophe. Among the several recommendations, the insurers have suggested considering setting up of national catastrophe insurance pools, which could provide efficiently priced, standalone catastrophe insurance to homeowners and small business owners.[74]

122. In view of insufficient demand for catastrophic risk coverage the introduction of mandatory law on compulsory property insurance against all natural and man-made catastrophes is under discussion. However, adverse public reaction is a concern whenever mandatory insurance is introduced.

123. Agriculture insurance. Kazakhstan preserved compulsory agricultural insurance in the post-Soviet era to help farmers manage their risks. Until 1997, the state insurance company, KazGosstrakh, provided insurance services for agriculture. Despite the legal requirement that legal farm entities take risk insurance for all operations, the market for insurance remained underdeveloped and few farms were insured. Those that did buy insurance usually did so only to meet formal requirements for other purposes, such as access to credit. In 1997, the government introduced mandatory agricultural insurance through a special provision in the Insurance law; additionally, the government established KazAgroPolis in 1998 to develop a public-sector supplier of crop insurance. However, its operations remained very limited and, after a last restructuring in 2001, KazAgroPolis lost its license for providing any type of insurance services.

124. During 1998–2002, the number of insurance companies offering agricultural insurance decreased from thirteen to seven, while premium rates were high, reaching 20%. In 2003, the government adopted a law on the state regulation of the financial market and finance institutions. In addition, only a limited number of agricultural insurance products are available on the market.

125. In 2004, a law on mandatory crop insurance for all crop producers was adopted,[75] and premium rates offered by insurance companies were in accordance with a tariff determined by the state. Today, subsidized multi-peril crop insurance is offered against damage to crops arising out of weather risks, such as hail, frost, drought, and floods. The government compensates 50% of losses reported by the participating insurance companies. It is administered by the state-owned joint-stock company, the Fund for Financial Support of Agriculture, which distributes government-allocated funds to promote agricultural insurance. In

[74] As has been demonstrated internationally, catastrophe pools can provide highly affordable coverage by realizing the benefits of country-wide risk diversification, economies of scale, and the ability to obtain better pricing terms from the global reinsurance market. The first countrywide catastrophe risk pool in an emerging market, known as the Turkish Catastrophe Insurance Pool, was pioneered and successfully launched with World Bank's assistance in 2000.

[75] The Law of the Republic of Kazakhstan N 533 dated March 10, 2004: On compulsory insurance in plant growing. The basic principles of agricultural insurance are defined in the Law on Mandatory Crop Insurance under which the amount of loss is determined as "a positive difference between the normative cost per one hectare of crop production, which is set at the moment of concluding an insurance contract, and the revenue from one hectare of crop production in the area affected by the adverse natural events, multiplied by the exact area on which the given crop was produced and which was affected by an adverse weather event."

addition, some private insurance companies and mutual assistance companies offer agricultural insurance under this subsidized program. Access to international reinsurance is a major constraint, which means that insurance companies in Kazakhstan retain all agricultural risks. Livestock insurance is voluntary and public information is not available.

126. The Ministry of Agriculture, with the support of the World Bank,[76] is revisiting the legal and regulatory framework, in addition to addressing issues related to weaknesses in risk assessment, rate setting, contracting, loss adjustment and reserving, and other management issues.

127. Islamic insurance. *Takaful*, or Islamic insurance, is in the concept stage, and a draft law and schemes are under discussion.

128. Reinsurance. Beyond considering the impact of reinsurance on the solvency of domestic companies, reinsurance regulation has not received much attention. This is partly due to the absence of a reinsurance regulatory model in Europe, on which most insurance regulations are based. Since there are no large local reinsurance companies, insurers cooperate with Russian and European companies, and "fronting" is prevalent.[77]

Table 13: Insurance Premiums in 2012 (tenge '000)

Insurance class	Total Insurance Premiums Accepted on Insurance Contracts	Total Insurance Premiums Accepted on Reinsurance Contracts	Total Insurance Premiums Transferred to Reinsurance	Net Sum of Insurance Premiums	Reserve Change of Unearned Premium	Change Of Reinsurer Share in Reserve of Unearned Premium	Net Sum of Earned Insurance Premium
Compulsory insurance	48,679,585	8,507,411	20,184,793	37,002,203	5,090,635	6,679,952	38,591,520
Voluntary personal insurance	85,154,985	2,019,162	1,257,248	85,916,899	6,380,554	309,949	79,846,294
Voluntary property insurance	77,678,535	15,103,548	43,719,659	49,062,424	6,037,751	-2,076,185	40,948,488
Total	**211,513,105**	**25,630,121**	**65,161,700**	**171,981,526**	**17,508,940**	**4,913,716**	**159,386,302**

Source: Financial Supervision Agency. 2013. "Insurance Sector. Total Statement on Insurance Premiums of Insurance (Reinsurance) Organizations of RK." Almaty. http://www.afn.kz/?docid=582 (Excel document).

[76] The principal objective of the Agricultural Post-Privatization Assistance Project is to enhance access to commercial financial services by farmers and small/medium size rural enterprises by (i) building capacity for viable rural businesses by strengthening and expanding the rural advisory services program, (ii) supporting agricultural risk management initiatives, (iii) facilitating the development and implementation of new financial instruments by commercial banks and leasing companies for deepening rural financial outreach, and (iv) supporting sustainable rural microfinance schemes for providing financial services to rural micro entrepreneurs currently excluded from the formal banking sector.

[77] Fronting is the process by which a primary insurer cedes all or virtually all of the insurance risk of loss to a reinsurer who also controls the underwriting and/or claim handling process, either directly or through a managing general agency. Often, the reinsurer is not licensed in the home country, which presents both business opportunities and problems for participants. Regulators have concerns about their ability to regulate those who are controlling business in their territory and solvency issues when such programs go wrong. Some countries attempt to regulate or prohibit this practice.

129. Reinsurance placements with institutions with low credit quality and outstanding claims recoverable from reinsurers with vulnerable or unknown ratings have contributed to adverse exposure to the insurance industry. Moreover, the supervisor has doubts about having adequate technical knowledge or resources to monitor ceding companies' transactions, particularly for risks being reinsured through entities in offshore jurisdictions.[78]

130. New regulation requires 60% of reinsurance to be retained in Kazakhstan. Putting in place insurance pools for disaster as well as aircraft risks is a priority given the lack of domestic capacity to underwrite.

131. Distribution channels. There is lack of knowledge about the pricing of insurance products and the design of benefits tailored to the needs of the customers, as well as the use of alternate distribution channels, such as bancassurance, mobile technology, and so on.

132. Insurance agents are not regulated, and insurers are responsible for training and maintaining a registry of agents. Banks act as agents through subsidiary insurance companies. However, as a result of the financial crisis, the utilization of the bank channel by insurers has become less popular due to a decline in lending.[79] In terms of a ripple-effect, this has also contributed to the reduction in premiums on life insurance and property insurance. In 2011, with the revival in bank lending, market premiums on lending-related insurance types is also on the rise. Although competition is increasing, the scale remains quite insignificant to encourage product innovation.

133. Insurers have had relationships with banks for some time, largely to place industrial risks for bank-funded projects, and these relationships are growing stronger as bancassurance becomes more prevalent. Bancassurance products have low losses and are thus attractive to insurers. Financial conglomerates do not intend to either lose or share this profit. As a result banks continue to mandate clients to insure with their affiliates when offering them a loan. The post office can also act as an agent for distributing insurance products. However, legislative barriers exist for transacting insurance business on the internet. Multilevel marketing of insurance policies is prevalent.

134. The commission levels for insurance agents as prescribed by the central bank are 60% in the first year, 30% in the second and third. After 3 years, the insurer gets directly in contact with clients. Agents' commission fees for compulsory insurance are defined by law, and cannot exceed 10% for individual agents and 15% for corporate agents.

135. There are 12 insurance brokers, of which 50% have foreign participation. There is no licensing requirement or any regulation in place to monitor their activities. Yet on-site inspections of 2–3 insurance brokers are planned annually.

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[78] Offshore reinsurance companies are reinsurers that operate in special geographic zones, often with less demanding regulatory and favorable tax environments. A great deal of reinsurance is conducted through these centers, although much of the actual management of these companies is done in the parents' home offices in Europe, London, and New York. The purpose of offshore reinsurance has been to optimize the use of capital and, thus, create competitive advantage. However, special scrutiny is required when offshore reinsurance is involved. The lack of strict regulation or the low capital requirements in some offshore centers can lead to failing reinsurers in major claims. Money launderers have also used this type of reinsurance. Rodolfo Wehrhahn. 2009. *Introduction to Reinsurance*. Primer series on insurance. Issue 2. April 2009. Washington DC: World Bank. http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1242281415644/Introduction_to_Reinsurance.pdf.

[79] Bancassurance grew steadily before the financial crisis, but external problems resulted in the tightening of belts by domestic insurers.

136. Currently there is no regulation and supervision of insurance/reinsurance brokers except the issuance of licenses and requirements for quarterly reporting on financials and contracts. Commission levels and placement of risk is not transparent.

137. Other insurance market participants. Adjusters and surveyors were introduced in 2010, but are not regulated. There are 80–90 actuaries, and licensing requirements (renewable every 3 years) include participation in training comprising six levels and related tests developed and conducted by the Actuarial Society of Kazakhstan.[80] The level of actuaries is quite adequate and they are involved in the calculation of reserves. The areas of responsibility of actuaries should be expanded beyond the calculation of reserves and include solvency monitoring and related areas. Their role is complemented by the Kazakhstan Actuarial Center, a consulting company established by the central bank in September 2001 to promote the development of the actuarial profession and to build up actuarial research and consulting capacity.

138. Ombudsman. An ombudsman is involved only in mandatory motor vehicle owners' liability insurance. It was initially set-up for dispute settlement between insurers, and scope was expanded to include disputes between insurers and clients. The Kazakhstan ombudsman is modeled on the English experience: mediation, recommendation, and resolution. The aim is to focus on the development of practice review, which will facilitate resolution without recourse to the ombudsman, to increase public awareness, and to follow up on legislation and proposals on sector development. The insurers fund the ombudsman and all insurers are obliged by the law to be members.

139. In 2011, 90% of claims were resolved through consultation and 10% by mediation; 76% of resolutions were made without the ombudsman's participation, although it is planned to increase this share in coming years. The quality of work has improved over time. The ombudsman not only decides on disputed claims, but also assists in mediation; insurers have agreed to expand the types of insurance covered under the ambit of the ombudsman.

140. Financial Institutions' Association of Kazakhstan (FIAK). FIAK was established in May 1999. Financial market participants—including banks, state financial development institutions, insurance companies, pension funds, securities market professional participants, leasing, mortgage, auditing and consulting companies, research and educational institutions—are united under the aegis of FIAK. Out of 37 insurers, 23 are FIAK members (four are life insurers and 19 general insurers).

1. Regulation, Supervision and Policy Issues

141. The central bank oversees supervision methodology. The two divisions of supervision in the FSC are (i) on-site supervision unified for all sectors, and (ii) off-site supervision—the banking sector supervision department (including the nonbanking sector) and financial institutions supervision department (the insurance sector and the capital market and pension sector supervision units). There are separate licensing departments for each subsector, including the winding up and liquidation department, the consumer department, and the enforcement and sanctions department.

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[80] The society was legally registered on February 27, 2001 and is an observing member in the International Actuarial Association. If incumbents pass their exams on courses 1–4 and the license exam, the National Bank of Kazakhstan grants a license for carrying out actuarial activity. Students who pass their exams on all 6 courses become active members of the society; 82 individuals are covered by the training program for actuaries, of which 36 have the actuarial license from the National Bank of Kazakhstan; 18 actuaries are active members of the Actuarial Society of Kazakhstan.

142. The principal objective of insurance supervision has been to license new companies that can be relied upon to maintain their solvency and to establish monitoring systems. The market is characterized by strong government monitoring with continuous reforms, as demonstrated by the establishment of the insurance ombudsman, a single insurance database, Insurance Inde Millionity Payments Guarantee Fund, and the introduction of the *bonus-malus* system. Recently, an "insurance holding company" definition was introduced to implement consolidated supervision. A separate department within the FSC carries out consolidated supervision. The bank supervision department also looks into certain aspects of consolidated supervision, which includes insurance companies.

143. A crisis resolution framework and norms for orderly winding up and exiting of problem companies (including enforcement, legal aspects, freezing of assets, and run-off business) are absent and need to be developed.

144. The Department of Surveillance and Control Methodology is responsible for coordination within the central bank for the implementation of international financial standards. The last assessment of Insurance Core Principles took place in 2004 and no report on observance of standards and codes was undertaken thereafter. The need for an effective supervisory structure is evident in the state of flux of the regulatory regime, with a number of different approaches to insurance regulation adopted over time, although most of the regulations are modeled on European Union directives. The Actuarial Society prescribes methodology for the calculation of reserves.

145. Unified Insurance Database. The database, in operation since 2010, is owned by the insurance (reinsurance) companies and includes all mandatory and three voluntary insurance types sold by all insurers. Insurers enter data on their insurance lines and receive reports. The NBK has considered to acquire a stake and participate in management. FIAK has suggested integrating the database with the Ministry of Internal Affairs' database to record and report information to supplement and complement central bank micro- and macro-level data requirements.

146. Insurance Inde Millionity Payments Guarantee Fund. Established in August 2003, the fund is managed by general insurers who are also the shareholders and covers liability insurance for tour agents and operators, motor liability, and auditors' liabilities. Under recent changes in legislation, life insurers now underwrite workmen accident insurance previously written by general insurers. In addition, the insured can receive compensation for life for any permanent disability or sickness, unlike before the amendment. Reflecting this, the scope of the fund has also been widened to include life insurance. Based on international experience and practice, members of the association are of the opinion that separate funds should be maintained for life and general insurance due to the different nature of liabilities.

147. Mandatory Motor Liability Insurance. This covers motor vehicle owner's liability. But the claims ratio remains low amid a lack of consumer literacy and confidence, with claims still settled on the road with no recourse to insurance. There is also an erroneous perception that insurance companies are focused on corporate customers. The introduction of a uniform insurance system, similar to green card,[81] to cover and unify with members of the Customs Union of Belarus, Kazakhstan and Russia and the People's Republic of China (PRC) has been

[81] An international civil liability motor insurance system ensures that claims initiated by victims of traffic accidents involving foreign drivers can be settled under the law of the country in which the accident takes place. The governments of about 50 member countries recognize the international green card certificate, which serves as evidence of a compulsory third party liability insurance policy in a foreign country.

under discussion for more than 7 years. Such a mechanism is important for regional integration, yet there is no commensurate support from government.

148. The customs union and Kazakhstan's involvement in the Eurasian Economic Community have necessitated the unification of insurance-sector-related legislation of Belarus, Kazakhstan, and the Russian Federation. To harmonize insurance legislation and unify the insurance markets by 2019, therefore, the formation of Eurasian Insurance Organizations Congress, an interstate insurers' union, was announced in June 2012. This will open the Russian Federation's reinsurance market to Kazakhstan's insurance companies. In addition, it could solve the problem of cross-border motor third party liability insurance by creating a unique data base for the entire economic region and by adopting legislation to allow for mutual recognition.

149. Workers' accident insurance. The market size is estimated at $100 billion. Since life insurers were mandated in January 2012 to underwrite workers' accident insurance, retail sales of traditional life insurance products have been hurt because the former involves both time and effort from the agency network for business acquisition. However, life insurers have taken steps to expand their network by recruiting and training more agents to distribute insurance.

150. Previously, nonlife insurers offered coverage for up to one year for occupational diseases. The insured was thereafter required to undergo an annual checkup. Under the new regime, lifelong compensation is required. As a result, loss reserves have increased and affected premium rates. However, due to maximum, legal limits, other insurance classes cross-subsidize the losses. There is a lack of clarity about dealing with this new regime because maximum rates remain the same as when nonlife insurers were underwriting. One suggestion is to segregate occupational disease and accident and create a separate fund for the former.

151. Capitalization and solvency. Most Kazakhstan insurers are small, captive insurance companies in nature, making them unable to access economies of scale.[82] Some of the smaller companies are also constrained by a lack of capital and absence of suitable investment options. Due to their small market capitalization, insurance funds are insufficient to underwrite and retain significant proportions of large corporate risks on the strength of their balance sheet. As a result, about 90% of corporate risk is reinsured.

152. The solvency regime is aligned with the Solvency I framework. Consolidation of the insurance industry is underway, along with a tightening of the prudential regulatory regime, and it is expected that some elements of the Solvency II framework are likely to be introduced soon based on a standardized formula. Some of the smallest insurers may face problems as a result, but their collective share of nonlife premiums is small.

[82] Captive insurance companies are insurance companies established with the specific objective of insuring risks emanating from their parent group or groups. Sometimes they also insure the risks of the group's customers.

Table 14: Main Financial Indicators of Insurance (Reinsurance) Organizations (tenge, '000)

	2008	2009	2010	2011	2012
Assets	268,822,898	297,252,217	343,234,390	387,671,977	442,647,713
Insurance reserves	86,265,636	101,011,539	114,919,173	127,858,440	174,148,373
Capital	165,929,357	180,480,027	208,657,566	232,162,447	239,727,189
Authorized capital	38,745,299	40,618,311	76,367,279	89,498,431	104,324,898
Retained income (not covered losses) of reported period	41,902,210	28,213,153	34,779,776	27,646,639	23,334,178
Insurance premiums	150,011,103	132,476,462	153,496,823	198,503,341	237,143,226
Net sum of insurance premiums	89,636,085	76,596,100	93,640,614	133,680,816	171,981,526
Expenses on insurance claims	57,459,092	29,829,792	27,139,608	46,139,245	75,697,244
Net expenses on insurance claims	27,101,899	17,139,128	24,238,011	35,019,867	61,322,686

Source: Financial Supervision Agency. 2013. *Insurance Sector. Information on Insurance (Reinsurance) Organizations of RK.* Almaty. http://www.afn.kz/?docid=596 (Excel document).

Table 15: Total Balance Sheet of Insurance (Reinsurance) Organizations of Kazakhstan (tenge, '000)

	2007	2008	2009	2010	2011	2012
Total assets	225,870,392	261,613,567	290,133,645	345,577,608	387,671,977	442,647,713
Total liabilities	99,808,518	100,338,538	116,405,477	138,127,595	156,509,530	202,920,524
Total capital	126,061,874	161,275,029	173,728,168	207,450,013	231,162,447	239,727,189
Total capital liabilities	225,870,392	261,613,567	290,133,645	345,577,608	387,671,977	442,647,713

Source: Financial Supervision Agency. 2013. "Insurance Sector. Total Balance-Sheet of Insurance (Reinsurance) Organizations of Republic of Kazakhstan." Almaty. http://www.afn.kz/?docid=572 (Excel document).

153. A few lines of the voluntary insurance business exist, but they have not matured enough to develop loss-reserving triangles or even apply the "chain-ladder method."[83] This is a prerequisite to developing proxies for Solvency II numbers before internal risk models are developed.

154. Regulations do not allow any special treatment of health insurance for treatment of capital for solvency purposes, even though the nature of the risk is different than other forms of insurance.

155. Currently, Kazakhstan Accounting Standards determine how capital needs to be calculated and what assets need to be considered for solvency purposes. The standards are more conservative and focused on policyholders in comparison to IFRS provisioning norms, which account for the solvency of insurers on a regular basis.

156. The three largest insurance companies hold 40.6% of the subsector assets. Among the issues that could prompt the credit rating agencies to give a negative rating include a downward trend in underwriting performance, a deterioration in risk-adjusted capitalization and the credit

[83] Nonlife insurance companies need to hold sufficient claims reserves on their balance sheets to meet all future cash flow obligations from outstanding loss liabilities. Actuaries therefore need to predict these future cash flows as accurately as possible: the chain ladder method is the most popular.

quality of investments, a sustained increase in credit risk exposure associated with reinsurance placements, and a decline in country-risk fundamentals.

157. Investments. An undeveloped capital market and the lack of good investment instruments have contributed to heavy investment by insurers in Kazakhstan's banking and corporate sector.[84] This not only makes it difficult for insurance companies to find profitable investments for their funds, but it can also encourage investment in low credit quality institutions, exposing the insurers to Kazakhstan's high financial system risk.

158. Insurers are subject to investment limits, which vary according to asset class. Investment guidelines for life insurers are very similar to those for the pension sector.

159. Generally, 10% of asset reserves are required to be covered by highly liquid assets. There are restrictions on offshore investments, and insurers can make use of hedging instruments. The absence of long-dated instruments (greater than 15 years) for investing reserves created under annuities poses a challenge.

160. Taxation of insurance companies. New amendments to legislation prescribe corporate income tax calculated as 20% of income from January 2012. Previously this was 4% of premiums minus reserves.

161. Taxation of insured. Although pension contributions are tax deductible, most customers are unaware of this and do not take advantage. Pension payouts are taxable, however, which demotivates prospective customers. There are no tax benefits to individuals and the insurance contribution by the employer added to an individual's salary income is taxable.

162. On-site and off-site inspection. For on-site inspections, FSC inspectors spend 2 months every 3 years in an insurance company. This covers issues such as regulatory compliance, reserves and provisioning of liabilities, and automatization requirements.

163. The reporting requirements and submission of returns are many and frequent, without the benefit of receiving timely feedback or analysis on the state of play either at the individual entity or aggregate level. For example, 20 returns need to be furnished every 10 days, 26 returns on a monthly basis, 23 returns on a quarterly basis, 1 return on a semi-annual basis, and 9 returns on an annual basis. Submission is required in hard copy and in electronic form.

164. Taking a cue from Chile, representatives of the off-site supervision department are located on-site for a prolonged period of time. The aim is to improve the quality of off-site supervision and reduce response time, given that on-site inspection occurs only every 3 years.

165. The off-site supervision department cooperates closely and shares information with the on-site department. This includes planning of inspections, defining the scope and terms of reference, data exchange, and feedback before and after inspections for follow up on recommendations and increased monitoring. The off-site department monitors market participants on a regular basis, raises issues to clarify, and follows up on the implementation of recommendations. The on-site department also cooperates with other departments, such as the consumer rights protection department, and collects all available feedback and data prior to inspections.

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[84] Assets in foreign exchange are only 2% of total aggregated assets.

2. Challenges

166. Although new foreign and domestic players are entering the insurance market in Kazakhstan, and statistics indicate that it is moving in the right direction, challenges remain. The slow growth of the insurance sector remains a concern given its potential to contribute to financial and economic development.

167. Factors constraining development, include

(i) fragmented market structures (many insurers do not have critical size to build adequate risk pools, underwrite contracts, and innovate);
(ii) the poor development of other segments in the finance sector;
(iii) weakness in regulation and supervision and consumer protection (resulting in a lack of transparency and trust);
(iv) unsupportive tax regimes, social and human development factors;
(v) lack of professionally qualified staff in insurance companies; and
(vi) the absence of products with cultural or religious preferences, especially in the life insurance segment. Policy and regulatory reforms, as well as product innovation, could foster the development of this sector.
(vii) And despite many cars, limited premium revenues are generated from motor insurance.

While policy makers cannot influence some of these factors, which only be changed very gradually, others can be addressed over a shorter time frame.

168. As part of a development plan for the insurance industry, further constraining issues include the following:

(i) A large number of companies sharing a small market, making individual insurers unable to generate adequate scale of business operations and leaving the insurance industry unable to retain sufficient volume of premiums on its books, build meaningful risk pools, and enhance underwriting capacity. Combined with moves towards mandating higher minimum capital requirements, this can lead to either intense competition or "faux fronting," in which insurance companies act as brokers or front offices of large reinsurers in disguise.[85]
(ii) The motor insurance portfolio has limited scope to generate sufficient premiums because (i) large segments of the population are unaware of the importance of this insurance and view it as a tax, (ii) poor claim settlement and validation procedures contribute to avoidance strategies by drivers who prefer to settle on the street, (iii) understatement of loss provisions and claim costs combined with price controls for compulsory motor third party liability insurance result in inadequate pricing, and (iv) predatory pricing in the belief that investment income will cover.
(iii) The small number of life insurers reflects the low development of this sector. Products tend to be traditional, bundled structures such as whole life and endowment, reflecting underdeveloped capital markets and limited actuarial resources.

[85] Much of the original fronting was carried out legitimately by captives of major international firms engaged in the extractive industries and seeking international capacity. This is becoming a less relevant subsector under non-admitted insurance rules and with the larger local insurers tending to handle this business (albeit with low retentions).

(iv) The lack of consistent, timely, and high quality data available to supervisors, the industry, and the public is a regulatory weakness.

(v) With the modernization of insurance laws and supervisory regimes, the insurance industry has begun to realize the benefits of professionally qualified staff. However, the number of personnel with professional skills and qualifications in insurance remains low. Numerous small insurers are "key-man" dependent. Insurers are reluctant to invest in training due to the high attrition of trained and qualified staff.

169. Recommendations to accelerate the development of the insurance sector include employing capital and noncapital techniques to encourage rationalization (with too many small and inefficient players), the removal of tax distortions, stabilization of the motor third party liability markets, strengthening of reporting and disclosure, and capacity development.

3. Roadmap

170. The proposed roadmap would be expected to produce greater transparency and efficiency in the insurance industry and expand coverage, with the outcome greater use of better insurance products to mitigate risk and to manage lives and assets. The technical assistance would have four outputs: (i) assess the insurance sector against IAIS insurance core principles, (ii) develop a robust analytical and reporting framework, (iii) help insurance industry participants define better designed products and alternate distribution channels, and (iv) strengthen the professional skills and expertise of the supervisors, industry participants, and local professionals.

Output 1: Assess the insurance sector against the IAIS insurance core principles and standards and identify weaknesses and opportunities in consultation with the insurance companies and intermediaries and stakeholders (such as an ombudsman)

171. Rapid economic growth, high rates of inflation, and underdeveloped financial markets tend to present both insurers and supervisors with challenging decisions. For the development of a well-regulated insurance industry, the NBK needs to bring the legal and regulatory framework for insurance up to IAIS principles and standards. The insurance core principle assessments are integrated in IMF surveillance through the Financial System Stability Assessment and the Report on the Observance of Standards and Codes and are useful for drawing links between the economy and the insurance sector, assessing the adequacy of supervisory practices, and identifying regulatory and supervisory gaps, as well as developmental issues such as legal processes, market discipline, access to insurance of the low-income population, and strengthening insurance skills and resources.

172. Information on regulation of reinsurance brokers and their performance criteria in developed countries would be useful in defining the contours for the introduction of regulation.

Output 2: Develop a robust analytical and reporting framework that (i) is capable of linking off-site and on-site monitoring for assessing the solvency of insurers and (ii) assists insurers in risk management (including management of assets and liabilities and reinsurance) and enhanced transparency and disclosure.

173. The collection and maintenance of reliable and accurate data is a significant function of the supervisory authority. Reliable data enables the supervisor to discern trends in the industry and within individual insurers. Off-site inspection refers to the process of reviewing the

information that is provided by the insurance companies and is an important part of the supervisory process. Preferably, the supervisory authority should have developed and maintained a database in which the information provided by insurers is entered. The database should be able to generate common ratios for each insurer, cohorts of insurers (where relevant), and the industry in aggregate. It should also have the capacity to generate trends over time in important variables—such as gross written premium, earned premium, risk accumulation, claims paid, expenses, and so forth—for each insurer, cohort, and the industry as a whole. Where such a database is not available, the supervisor needs to calculate the ratios. Testing the accuracy of data submitted by insurers, on either a full-scale or a focused basis, and investigating areas of specific concern, is part of on-site inspection. Having reviewed the data provided by the insurer and compared it with previous reports and cohort and industry data, the supervisor needs to form a view about any change to the risk assessment of the insurer since the previous on-site or off-site review, whichever is later. It is essential to maintain proper documentation of each inspection, besides providing information about both current and pending issues. Automation of the database for facilitating off-site and on-site inspections and systematization of inspection processes by linking off-site and on-site inspection, as well as the inspection of affiliated entities, —as is commonly done in developed countries—should be taken up on a priority basis.

174. Strengthening the role of actuarial services for supervision is an area of focus. Improved reporting and analysis (supervisory returns and financial condition statements) from an actuarial perspective is important for the development of a sound risk based prudential insurance regime.

175. An information technology based reporting and analytical tool could link off-site and on-site inspections and make them more efficient and effective for a sparsely staffed supervisory office. The department could analyze and comment on different data and returns in a timely manner and share findings on key risks, trends, and opportunities with individual insurers and the insurance industry. The same tool could also assist insurers in their day-to-day risk management and monitoring and avoid duplication of resources.

176. This would also form the basis for suggesting the implementation of risk-based capital requirements on the lines of Solvency II on a pilot basis for those health insurers who have at least 80% of premium income emanating from health. The implementation of a more universal, risk-based capital approach could be considered at a later date when capital markets are more developed, stronger actuarial and accounting professions have emerged, and a minimally acceptable solvency regime is in place. It would also enhance the regulation and supervision of the insurance market for increased transparency and efficiency.

> Output 3: Assist insurance industry participants in defining better designed products (including disaster risk insurance) and alternate distribution channels, and share experiences from other countries.

177. Disaster insurance. The government should encourage and support the development of private sector solutions such as insurance, reinsurance, or alternative risk transfer tools, limiting exposure and providing a favorable legal, fiscal, and regulatory environment. The central bank should encourage insurance companies to provide information about their risk accumulations in terms of sums insured and Probable Maximal Loss estimates by Catastrophe Risk Evaluating and Standardizing Target Accumulations zone.[86] This would enable private insurance markets

[86] Catastrophe Risk Evaluating and Standardizing Target Accumulations is an independent organization established by the insurance and reinsurance industry in 1977 for the technical management of natural hazard coverage. Its main goal is to establish a uniform and global system to electronically transfer aggregated exposure data for accumulation risk control and modeling among insurers and reinsurers. Today, the standards are generally

to function properly and allow insurers to assess and evaluate the risks that they underwrite with a sufficient level of precision.

178. The entire range of catastrophe risk financing tools available needs to be fully utilized, including options to access capital market instruments to lessen the risks posed by natural disasters with expert support. Should global insurance and reinsurance markets prove costly, an alternative is the catastrophe bond market in which investors buy high yield bonds from the party that seeks to be insured. These bonds can either be backed by premiums collected on insured assets, or can be structured as a financial option using other calibrations. Another insurance innovation the government could facilitate is the creation of a central pool for catastrophe risk.

179. A mechanism could be considered in which liquidity and credit enhancement facilities support insurance coverage against catastrophic risks. The domestic insurance industry would transfer catastrophic coverage to a central pool regulated by the FSC but operated by the insurance industry itself. The risks covered would not be reflected on the balance sheets of local insurers but would be liabilities of the pool. The international insurance industry could then reinsure catastrophic coverage under the fund up to a specified loss limit. Multilateral institutions like ADB may provide contingent credit at the next highest loss level, supporting the liquidity of the pool in the event of immediate large losses in the initial years of operation.

180. To develop the insurance market and expand the coverage, the population should be introduced to better-designed insurance products as a risk mitigation tool to manage their risks, both lives and assets, and enhance the public perception of and confidence in insurance. Products generally available from insurers are not designed to meet the specific characteristics of the low-income market, particularly the irregular cash flows of breadwinners in the informal economy. Other key product design challenges include inappropriately insured amounts, complex exclusions, and indecipherable legal policy language, all of which conspire against effectively serving the low-income population and small business. Commercial insurers need to identify strategies to address these challenges and translate them into business opportunities.

181. Risk management capacity and technical product knowledge could develop the insurance market and help strengthen public confidence. For example, life insurance companies could gain from added experience in developing, introducing, and pricing new insurance products and selling pension and disability annuities.

182. One of the primary stumbling blocks in expanding insurance is the high transaction cost associated with distributing and managing large volumes of small policies. To improve penetration levels the market opportunities offered by alternate distribution channels—such as mobile phones, ATMs, kiosks, service points, utility providers, internet, microfinance institutions, mutuals, and so on—need to be explored alongside recommendations for amendments to the regulatory framework, if deemed necessary. In this context, international developments in other countries, as well as the evolution of international best practices may be considered.

Output 4: Strengthen the professional skills and expertise of the supervisors as well as the industry participants and local professionals by expanding awareness of risks and their estimation and management.

183. The capacity of insurance supervisors needs to be strengthened. Capacity building/training for the assessment of solvency and other prudential issues and the

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accepted and applied throughout the insurance industry worldwide.

implementation and monitoring of corporate governance norms, taking into account corporate governance and financial management, is recommended.

184. The training of supervisors for dealing with institutions and entities in offshore jurisdictions, and the risks/transactions that they should be mindful of, is important. Also relevant are

- capacity building/training to adequately assess companies' risk exposures,
- understanding the procedure of transfer of insurance risk and premium to international reinsurers,
- evaluating the adequacy and credit quality of their reinsurance programs,
- the implications of changes to insurance contracts' terms and conditions,
- pricing and commissions, and
- the legal implications of the regulation of the reinsurance business and reinsurance brokers.

185. Also useful would be learning from international experience in combating money laundering and the financing of terrorism through the insurance/reinsurance (cross-border) business. This would help the central bank to improve the quality of reinsurance supervision and move it in the direction of risk-based supervision of insurance companies' solvency and catastrophe risk transfer practices.

Table 16: Summary of Recommended Technical Assistance for the Insurance Sector: Outcome and Outputs

Outcome for technical assistance	Output of technical assistance
Population uses improved insurance products as a risk mitigation tool to manage their lives and assets.	• assess the insurance sector against International Association of Insurance Supervisors insurance core principles. • develop a robust analytical and reporting framework for risk management (including reinsurance and investment portfolio) and monitoring solvency. • help insurance industry participants define better designed products (including disaster risk insurance) and alternate distribution channels. • strengthen the professional skills and expertise of the supervisors industry participants, and local professionals.

E. Securities Market Development

1. Supply of Securities

186. The securities market in Kazakhstan is in the early stages of development. By comparison with Malaysia, also a resource-rich country, Kazakhstan's GDP was around 60.39% of Malaysian GDP in 2010 (Table 17).[87] However, stock market capitalization in Kazakhstan represented was 24.6% and domestic credit to the private sector 35.5% of the respective Malaysian indicators. The state contribution to the capital markets in Kazakhstan is less pronounced than in Malaysia, as demonstrated by its central government debt at 10.19% of GDP at the end of 2010.

[87] In addition to oil, Malaysia produces palm oil and rubber, among other things.

Table 17: Kazakhstan and Malaysia—Selected Economic and Financial Market Metrics

	2009		2010		2011	
	Kazakhstan	Malaysia	Kazakhstan	Malaysia	Kazakhstan	Malaysia
GDP at current prices ($ billion equivalent)	115.31	202.25	149.06	246.82	188.05	287.94
Stock market capitalization (% of GDP)	50.00	126.55	41.03	166.33	23.03	137.21
Central government debt total (% of GDP)	9.51	50.84	10.19	51.21	10.50[a]	...
Domestic credit to private sector (% of GDP)	50.27	111.61	39.30	110.68	36.00	112.20

... = not available.
[a] From the International Monetary Fund. 2012. *Republic of Kazakhstan: 2012 Article IV Consultation.* Country Report No. 12/164. Washington, DC. http://www.imf.org/external/pubs/ft/scr/2012/cr12164.pdf.
Source: World Bank. 2012. *World Development Indicators.* Washington, DC: World Bank.

187. The range of products available on the securities market is relatively limited. Financial instruments listed and/or traded on KASE include foreign exchange (spot and foreign exchange swaps), equities, government securities (primary and secondary), corporate bonds, futures, and repos (Table 18).[88]

Table 18: Kazakhstan Stock Exchange—Trade Volume Selected Instruments ($ billion)

	2011		2012	
	Volume	**Total** (%)	**Volume**	**Total** (%)
Foreign currency	106.2	52.8	96.1	52.12
- spot market	80.8	40.2	62.7	34.04
- swap market	25.4	12.6	33.3	18.09
Kazakhstan government securities	7.7	3.8	8.7	4.72
- primary market	4.6	2.3	7.2	3.88
- secondary market	3.1	1.5	1.6	0.84
Shares	1.1	0.5	1.4	0.75
Corporate bonds	2.0	1.0	2.1	1.14
Repo transactions	84.0	41.8	76.1	41.27
- “nego” repo on GS	0.0	0.0	0.0	0.00
- autorepo on GS	83.6	41.6	75.7	41.06
- nego repo on CS	0.0	0.0	0.0	0.02
- autorepo on CS	0.3	0.1	0.4	0.20
Total volume	**201.0**	**100.0**	**184.3**	**100.00**

GS = government serial securities; CS = corporate serial securities; nego repo = repo transactions carried out by direct method; autorepo = repo transactions carried out automatically.
Source: Kazakhstan Stock Exchange. 2013. “Volume and Structure of the Market (comparative data).” Almaty. http://www.kase.kz/en/page/reports.

188. Globally, equities are typically the most frequently traded product on exchanges. In Kazakhstan the most frequently traded instruments on KASE are repo transactions and spot foreign exchange, contributing 41.79% and 40.20% respectively to trading volume in 2011. The bulk of repo transactions, whether on government or corporate bonds, are conducted on KASE. Given that repos tend to be relatively standardized, on-exchange trading of repos is not

88 There are futures contracts for selected equities, stock exchange indices, and foreign exchange.

necessarily an issue, provided that the supporting infrastructure is in place; however, in Kazakhstan, standardized documentation in the form of the Global Master Repurchase Agreement (GMRA) has not yet been adopted, although some of the GMRA regulations have been included in KASE repo rules. But it is unusual that overnight repos in government bonds are almost exclusively conducted on an exchange.[89]

189. Securities in Kazakhstan are dematerialized. About 50% of total securities (equities and bonds) are listed. The Central Securities Depository data indicates that close to 77% of trades take place on KASE. KASE does not fully guarantee settlement, unlike international exchanges. Market players can negotiate directly, but generally choose to place the trades on KASE to benefit from clearing and settlement through the Central Securities Depository. As information about over-the-counter (OTC) trading is not publicly disseminated, although Central Securities Depository data indicates about 23% OTC trading, it is not possible to accurately quantify the volume.

190. **Market Infrastructure.** A critical success factor for securities markets is the presence of supportive market infrastructure. Robust and efficient clearing and settlement systems facilitate investment and trading, improving market liquidity. In addition to system infrastructure, markets could also look to aligning their bond conventions and practices with international standards, such as adopting the GMRA to document repo transactions.

191. The Integrated Securities Registrar created in December 2011 acts as the central registry for NBK Treasury notes and government bonds, with the prospect of also including other securities.[90] Trades are also processed manually in the event of a breakdown in electronic systems.

192. The clearing and settlement system at the Central Securities Depository provides a form of delivery-versus-payment as defined by the Bank for International Settlements. Transfer instructions for both securities and cash are settled on a gross basis, with final transfers of securities and funds at the end of the processing cycle, which is currently T+0 (same day settlement).[91] Hence there is a time difference in the movement of securities and funds, that is, not simultaneous settling; but both sides are checked before transferring and transfers are settled on the same day.[92]

That said, settlement risk is an ongoing issue in Kazakhstan's securities market for several reasons. The custodian for accumulative pension funds can cancel a trade prior to execution if completing the trade will breach the fund's investment guidelines. At the same time, there are two cash settlement systems—the NBK settles the cash leg for banks, while the Central Securities Depository settles the cash leg for nonbanks—and since there is no direct communication between the central bank and the Central Securities Depository this creates settlement risk. The Central Securities Depository therefore instructs the NBK to settle the cash leg, but there may be insufficient funds in the account of the (purchasing) bank. The Central

89 This topic is reviewed under the section on money market.

90 The Integrated Securities Registrar is, as of 1 January 2013, the sole organization in Kazakhstan administering the system for registering securities holders.

91 The global standard for the settlement period in both bond and equity markets is between T+1 and T+3 (Recommendations for securities settlement systems (RSSS) and Principles for financial market infrastructures (the PFMIs) as defined by the Bank for International Settlements (BIS) and Committee on Payment and Settlement Systems (CPSS) International Organization of Securities Commissions).

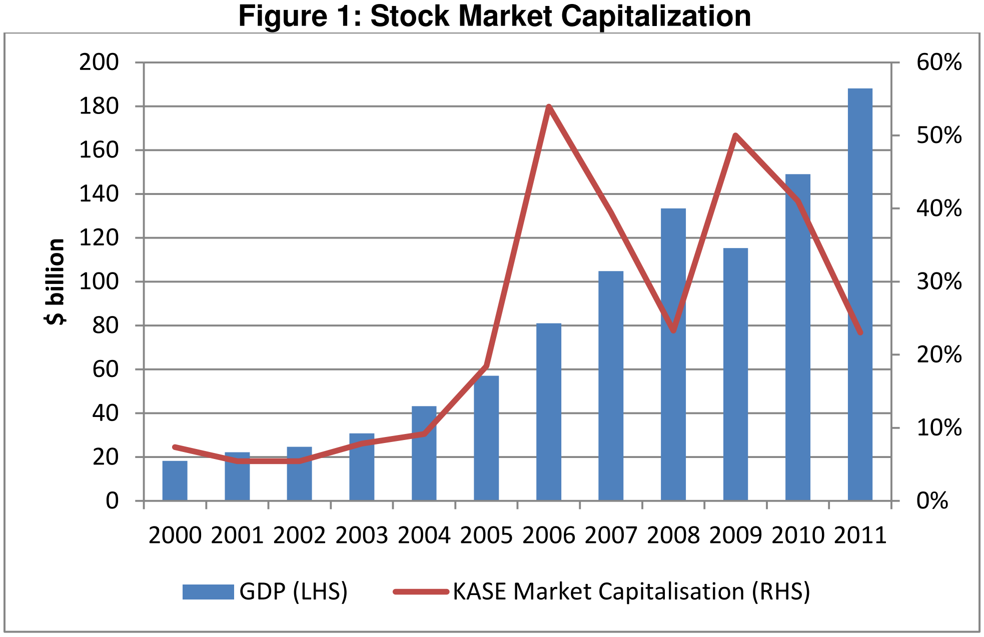
92 According to KASE, the time difference between settlement of cash and securities legs is in the range of 3–6 minutes.

Securities Depository, meanwhile, has settled the securities leg unaware that the cash leg has not settled.

193. Although there has been considerable discussion on the topic, the central bank still requires all securities trades to be pre-funded in order to reduce the risk of failed trades—notwithstanding the constraints this policy imposes on market development (see Box 2). Requiring that all trades are pre-funded acts as a major disincentive for nonresident investors, not only for practical reasons. Nor does pre-funding solve the problem of failed trades. In the 4 months from 1 September 2011, the Central Securities Depository recorded 891 failed trades for a total volume of T315.58 billion ($2.14 billion).[93] Of these, around 82% (by volume) are associated with the OTC market, with the remaining 18%, T56.4 billion ($ 382 million), being on-exchange trades. Since 77% of trading takes place on KASE, the high level of failed trades in the OTC market may reflect the disorganized state of this market. However, the relatively high level of failed trades on KASE may partly reflect that KASE does not fully ensure the guarantee of trades.

194. **Equities.** The purpose of the equities market is to provide the real economy with an alternative source of funds to debt, whether in the form of bank loans or bonds. Hence, a robust equities market underpins economic growth. Kazakhstan has the largest stock market in Central Asia, both relative to GDP and in absolute terms.[94] Among its global peers, relative to GDP the equity market in Kazakhstan ranks 49th out of a total of 97 countries—ahead of Ukraine at 55th. As of the end of 2011, stock market capitalization was $43.3 billion, with Ukraine having the next largest market at $25.6 billion. Relative to GDP, stock market capitalization in Kazakhstan stood at 23% versus Ukraine at 15.6%. Figure 1 charts movements in stock market capitalization in Kazakhstan since 2000 against GDP.

Figure 1: Stock Market Capitalization



Source: World Bank. 2012. "Kazakhstan. World Development Indicators." Washington, DC. http://data.worldbank.org/country/kazakhstan.

93 Central Securities Depository internal statistics.
94 World Bank. World Development Indicators. http://databank.worldbank.org/ddp/home.do?Step=3&id=4.

195. As of February 2012, a total of 91 share issues from 66 issuers were listed on KASE,[95] while equity market capitalization stood at $43.4 billion as of 31 December 2011. In December 2012, Kcell, Kazakhstan's largest mobile phone operator, raised $525 million in its debut initial public offering. The offering, during which Kcell floated a 25% stake, was priced at $10.50 per global depositary receipt and 1,578.68 tenge ($10.46) per ordinary share.

196. KASE classifies equities in three categories, with the first category subject to the strictest listing requirements. The third category is the largest category and is meant for start-up companies, but most majority shareholders do not want to dilute their stake, so list in category 3.[96] In total 15 shares from 9 issuers are listed in the first category, 17 shares from 11 issuers in the second category, and 59 shares from 48 issuers in the third.[97]

197. Secondary market liquidity in equities is shallow. Total trading for 2011 amounted to $1.01 billion, down 42.8% from the previous year and representing just 0.5% of KASE trading volume over the year.[98] As of the end of February 2012, the free float (as measured by KASE methodology) of the 13 largest companies by market capitalization on KASE was 28.8%, that is, more than 70.0% of the 13 largest companies is owned by shareholders who hold more than 5.0% of the shares of the individual companies. Furthermore, the ratio of trading volume to market capitalization is 2.3%, evidence of the low level of liquidity. Market operators estimate that only around 1.0% of stock market capitalization is represented by free float, with owner concentration, conversely, being high. The problem of this small free float is compounded by inadequate protection of minority shareholders.

198. Listing criteria were amended in 2011 to include a free float rule for both first and second category shares. For first category shares, the rule requires that at least 10% of outstanding shares (except those redeemed, encumbered and/or blocked) should be available for trade 6 months from the opening of trade in the shares, with 15% available after 1 year and 25% after 2 years.[99] Where the floatation involves a company with more than 50% state ownership as of the listing date, at least 5% of outstanding shares should be trading after 6 months and 10% after 1 year. For shares listed in the second category, the free float requirements are 5% after 6 months, 10% after 1 year, and 15% after 2 years. If state ownership exceeds 50%, then 5% of the shares should be available for trading after 6 months.

199. Reflecting growing interest in the region's financial markets, Kazakhstan was placed on the watch list for admission to frontier status on the FTSE Global Equity Index Series in September 2008 (see Box 2). FTSE is continuing to engage with officials at KASE. However, until the T+0 settlement cycle is brought into line with international standards, there will be no changes to FTSE's assessment of Kazakhstan's market against the quality of market criteria at this point. As of March 2011, Kazakhstan remained on the watch list.

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95 Including common and preference shares.

96 Companies listed in category 3 are still required to meet disclosure requirements and pay listing fees.

97 All figures taken from the Kazakhstan Stock Exchange at http://www.kase.kz/en/ticker—securities in different categories of the official listing may be issued by the same issuer, so that the number of issuers in each category sums to more than the total number of issuers shown.

98 Total trading volume in 2010 was $1.9 billion, representing 0.9% of total trading on KASE. http://www.kase.kz/en/reports.

99 European Union regulations specify that the free float should comprise 25% of equity in order to be supportive of listing.

Box 2: FTSE Frontier 50 Index

The FTSE Frontier 50 Index is FTSE's first created from an eligible universe of 25 new frontier markets, which has been screened using its established country classification methodology that assesses markets against the size requirements, basic governance, and market infrastructure elements required by international institutional investors. The new index is calculated in real time and is designed to be used as the basis of financial products such as exchange-traded funds, mutual funds, and derivative products.

The markets were identified using five criteria from FTSE's renowned country classification criteria:

- There must be a formal and independent stock market authority that actively monitors the market.
- There should be no objection to or significant restrictions or penalties applied on the repatriation of capital and income.
- Transparency. There should be market depth information, visibility, and a timely trade reporting process and a requirement of international price dissemination.
- Settlement. There should be only rare incidence of failed trades.
- Clearing and settlement period shorter than T+7 (and greater than T+1).

Markets must also meet a minimum country free float size requirement of $750 million.

Countries presently listed as eligible for the FTSE Frontier 50 Index are: Argentina, Bahrain, Bangladesh, Botswana, Bulgaria, Cote d'Ivoire, Croatia, Cyprus, Estonia, Jordan, Kenya, Lithuania, Macedonia, Malta, Mauritius, Nigeria, Oman, Qatar, Romania, Serbia, Slovakia, Slovenia, Sri Lanka, Tunisia, Vietnam.

Source: FTSE. "FTSE Frontier 50 Index." http://www.ftse.com/Indices/FTSE_Frontier_Indices/index.jsp

200. **Money Market.** The interbank and money markets form the foundation of all financial and capital markets for two reasons: (i) they provide the mechanism which allows financial institutions to manage their liquidity by borrowing from and lending to one another, in the process reducing liquidity risks by providing access to the immediate cash market; and (ii) they allow the central bank to inject and withdraw liquidity, in the process guiding short-term interest rates. At the same time, an active money market is a prerequisite for the development of government bond markets.

201. The repo market plays a critical role in generating secondary trading activities that add breadth and depth to bond trading, as an efficient repo market allows participants to lend and borrow government bonds efficiently. Thus, support for the bond market results from increasing liquidity in the underlying securities by making it cheaper and less risky for financial institutions to maintain inventories of government bonds for subsequent sale to investors and to fund trading portfolios of the securities.[100] At the same time, the repo market enables investors to carry out relative value strategies that would capitalize on pricing anomalies and create a more dynamic and responsive yield curve. An efficient repo market is therefore (i) a key element in a liquid bond market, (ii) supports secondary market activities, (iii) provides market players with a means of financing positions and enables them to take advantage of yield curve arbitrage opportunities, and (iv) facilitates portfolio management.

202. The money markets in Kazakhstan remain undeveloped and thus provide limited support for securities market development. Short-term notes and deposits of banks with the NBK are the main instruments for interest rate regulation in the financial market as well as for sterilization of

[100] This latter point is a key factor in encouraging market intermediaries to participate in primary and secondary bond market activities.

excessive bank liquidity.[101] The interest rate band set by the central bank has been unchanged since 2010; the upper end of the band, the refinancing rate, is 7.0%, while the lower end is 0.5% for weekly deposits and 1.0% for monthly deposits. It appears that open market operations are not widely used to influence the interbank market, and hence liquidity in the financial system.

203. As noted above, NBK tends not to use indirect instruments such as open market operations for monetary policy purposes. Overnight repos in government securities therefore seem to have a limited role in the implementation of monetary policy. Rather, it prefers to offer 7-day repos with overnight repos being conducted on KASE. As noted,[102] it is unusual for NBK repos to be conducted primarily on the stock exchange and runs contrary to financial markets in other jurisdictions.[103] At the same time, NBK sets the 7-day repo rate for government bonds at the same level as the refinancing rate. The NBK also does not accept overnight deposits; it only accepts 1-week or 1-month deposits. In the event of a liquidity squeeze, it seems that the NBK buys back Treasury notes at the refinancing rate or releases 1-week deposits, albeit with an interest penalty. As a result, liquidity squeezes tend to occur 3–4 times each year, lasting 1–2 weeks. During these periods, the overnight rate jumps from close to 0% to 10%, while the 1-week rate increases from 2% to 5%.

204. The NBK conducts Treasury note auctions each Friday in maturities ranging from 3–9 months through a panel of primary agents.[104] In total, there are around 20 primary agents with brokerage licenses, but only 10 are active—the active primary dealers are primarily banks. Details of NBK auctions are published at the beginning of each month leaving participants limited time to manage liquidity. NBK issues are between T30 billion–T200 billion ($203 million–$1.355 billion) and the auction takes place OTC. In the recent past, auctions of Treasury notes have been in the order of T60 billion ($406 million), but since the fourth quarter of 2011, the take-up at Treasury note auctions has only been 25%–50%; one explanation for this is that bids were at higher yields than the central bank was prepared to pay.

205. Excess liquidity tends to build up in the interbank market throughout the month as contributions to accumulative pension funds are made on a weekly basis. At the time of the auction of government long-term savings treasury obligations (MEUJKAM) this liquidity drains from the market, only for the cycle to be repeated the following month. In addition to problems with liquidity management, market development is constrained by the lack of an instrument to hedge interest rates. Attempts have been made to introduce a money market reference rate, KazPrime. However, this floating benchmark is not widely used as amounts quoted for this index were low ($1 million). Figure 2 charts Kazakhstan's interbank money market indices: KazPrime, the Kazakhstan Interbank Offered Rate,[105] and Tenge Overnight Index Average (Tonia).[106] Typically, a money market index would reflect conditions in the underlying market. In Kazakhstan's money market, KazPrime and Kazakhstan Interbank Offered Rate three months are relatively stable, indicating that these rates may not be reflective of money market conditions. Only Tonia shows evidence of the volatility typically associated with an active

[101] National Bank of Kazakhstan. 2011. "Monetary Policy Guidelines of the Republic of Kazakhstan for 2011." http://www.nationalbank.kz/index.cfm?docid=578..

[102] See paragraph 200–201.

[103] Box 3 reviews the role of repos in supporting development of the government bond market in Singapore, among other things.

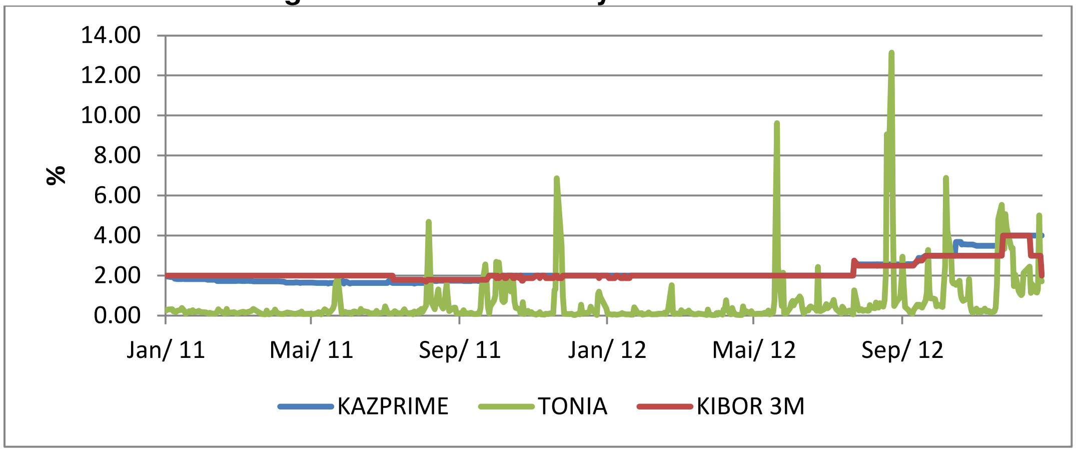
[104] Details of auctions for the upcoming quarter are announced at the end of the previous quarter, while terms and conditions of forthcoming auctions are announced on the preceding Wednesday.

[105] 3-month Kazakhstan Interbank Offered Rate.

[106] Tenge Overnight Index Average—the weighted average rate on one-day repo transactions opening deals on the KASE automatic repo market in government securities.

interbank market. However, it is not appropriate to use Tonia as a money market benchmark reference as it is an overnight repo rate, secured on government bonds.

Figure 2: Selected Money Market Indices



Source: Kazakhstan Stock Exchange. http://www.kase.kz/en/main.

206. **Government bonds.** Two state borrowers issue government securities: the NBK issues Treasury notes in 3-, 6- and 9-month maturities; and the Ministry of Finance issues government bonds in maturities of no less than 6-months. Because both the NBK and the Ministry of Finance are issuing government obligations in 6- and 9-month maturities—and since both issuers represent the same credit, the government of the Republic of Kazakhstan—the securities are substitutes, which fragments the market and raises issuing costs for both issuers.

207. In November, the Ministry of Finance publishes aggregate information about the annual auction calendar for the coming year. It publishes the issuance calendar for the coming quarter on the website at the end of the previous quarter, with specific terms and conditions for each auction published 2-days before the auction. The ministry conducts the auction of government securities 2–3 times a week, and any member of KASE can submit bids at the auction,[107] that is, a list of primary dealers has not been specified.[108]

In addition to Treasury notes, five types of government obligations are presently outstanding (Table 19). Of these, government medium-term special treasury obligations (MAOKAM) were only issued in 2009,[109] and MEUJKAM are offered exclusively to pension funds. Starting on 15 July 2012, only KASE members can submit applications for participation in the specialized trading for initial placement of the government securities of the Republic of Kazakhstan, which are second-tier banks, accumulative pension funds, or companies implementing the investment management of pension assets. The second-tier banks may enter into transactions on behalf of and at the cost and benefit of clients who are second-tier banks, accumulative pension funds, insurance companies holding a life insurance license, or companies handling the investment management of pension assets. These companies can participate in the auction only at the cost and benefit of accumulative pension funds.[110]

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[107] The 78 members of KASE include brokers, banks, asset managers, and accumulative pension funds.
[108] This is unlike Treasury bill auctions, for which the NBK has specified a list of 20 primary agents.
[109] Two tranches of these retail-targeted securities were issued in 2009—the 2-year maturity that was repaid in 2011 and a 3-year maturity was due in 2012.
[110] According to the NBK resolution "On amendments and Additions to the resolution of the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations N170", as of 29 October 2008 "On Approval of the Rules for Conducting the Activity of Trading in Securities and Other Financial Instruments N61" of 24 February 2012. http://www.nationalbank.kz/?docid=971.

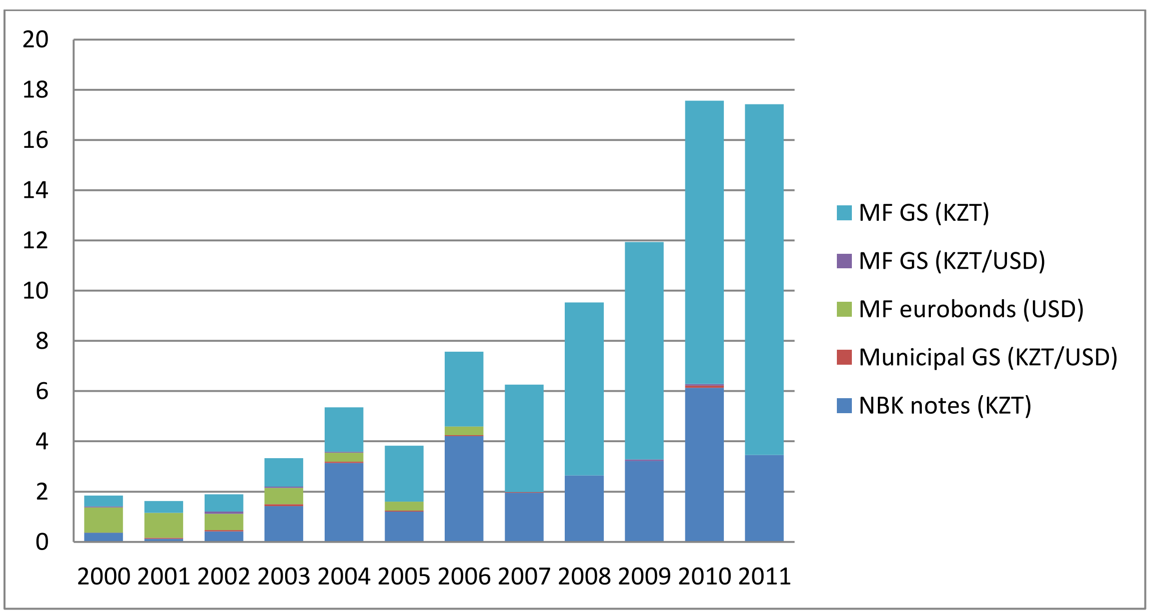
Table 19: Government Securities Issued by the Ministry of Finance

Name of Security	Maturity (months)	Description
Government short-term treasury obligations (MEKKAM)	6, 9, 12	• Nominal value = T100 • fixed rate
Government medium-term treasury obligations (MEOKAM)	12–60	• Nominal value = T1,000 • Fixed rate • Semi-annual coupon
Government medium-term special treasury obligations (MAOKAM)	12–60	• Nominal value = equivalent to $10 • Fixed rate, indexed to consumer prices index • Semi-annual coupon • Initial allocation for individuals only
Government long-term treasury obligations (MEUKAM)	> 60	• Nominal value = T1,000 • Fixed rate • Annual coupon
Government long-term savings treasury obligations (MEUJKAM)	> 60	• Nominal value = T1,000 • Floating rate, indexed to consumer price Index • Annual coupon • Restricted to pension funds for first half of maturity, later—free trade

Source: Ministry of Finance.

208. Figure 3 charts the evolution of Kazakhstan government. Whereas in 2000 more than 50% of government issuance was in Eurodollar bonds, the share of tenge-denominated government bonds issued by the Ministry of Finance has grown progressively since 2006, from close to 40.0% to around 79.5% at the end of 2011.

Figure 3: Dynamics of Kazakhstan Government Debt (end of period)



GS = government security, KZT = Kazakhstan tenge, MF = Ministry of Finance, USD = US dollar.
Source: Kazakhstan Stock Exchange.

209. The Ministry of Finance issuance calendar specifies the auction dates, types of securities to be issued, and planned volumes (Table 20). However, according to market participants the government bond issuance calendar is not strictly adhered to.

Table 20: Ministry of Finance—State Securities Issue Plan for 2012

Month of auction	Date of Auction	Type of Security	Planned Volume of Placement (tenge million)
	1/5/2012	MEOKAM-60	15,000
	1/10/2012	MEKKAM-12	12,000
January	1/12/2012	MEOKAM-36	10,000
	1/18/2012	MEUKAM-120 repeat	16,000
	1/30/2012	MEUJKAM-132	12,000
Total			
	2/6/2012	MEKKAM-12 repeat	13,000
	2/9/2012	MEOKAM-24	10,000
February	2/15/2012	MEOKAM-48	15,000
	2/22/2012	MEUKAM-84 repeat	10,000
	2/28/2012	MEUJKAM-204	20,000
Total			
	3/6/2012	MEOKAM-36	10,000
	3/14/2012	MEOKAM-60	15,000
March	3/19/2012	MEUKAM-120	15,000
	3/27/2012	MEUKAM-180	20,000
	3/29/2012	MEUJKAM-168	15,000
Total			
	4/4/2012	MEKKAM-12	15,000
	4/11/2012	MEOKAM-24 repeat	10,000
April	4/18/2012	MEUKAM-192	10,000
	4/24/2012	MEUKAM-240	15,000
	4/27/2012	MEUJKAM-156	20,000
Total			
	5/3/2012	MEKKAM-12 repeat	15,000
	5/7/2012	MEOKAM-36 repeat	10,000
May	5/15/2012	MEUKAM-132	10,000
	5/23/2012	MEUKAM-108	20,000
	5/30/2012	MEUJKAM-216	15,000
Total			
	6/6/2012	MEOKAM-60 repeat	10,000
	6/13/2012	MEUKAM-72	15,000
June	6/19/2012	MEUKAM-120 repeat	15,000
	6/21/2012	MEUKAM-240 repeat	15,000
	6/28/2012	MEUJKAM-204	20,000
Total			
	7/4/2012	MEKKAM-12	10,000
	7/11/2012	MEOKAM-60 repeat	15,000
July	7/18/2012	MEUKAM-180	20,000
	7/25/2012	MEUKAM-192	10,000
	7/30/2012	MEUJKAM-228	20,000
Total			
	8/6/2012	MEKKAM-12 repeat	15,000
	8/15/2012	MEOKAM-48	15,000
August	8/21/2012	MEUKAM-72	15,000
	8/23/2012	MEUKAM-108	20,000
	8/28/2012	MEUJKAM-168	15,000
Total			
	9/5/2012	MEOKAM-60	15,000
	9/12/2012	MEUKAM-120 repeat	10,000
September	9/18/2012	MEUKAM-180	20,000
	9/20/2012	MEUKAM-192	10,000
	9/27/2012	MEUJKAM-228	20,000
Total			

Month of auction	Date of Auction	Type of Security	Planned Volume of Placement (tenge million)
October	10/4/2012	MEKKAM-12	10,000
	10/10/2012	MEOKAM-60	15,000
	10/17/2012	MEUKAM-96	20,000
	10/24/2012	MEUKAM-144	20,000
	10/30/2012	MEUJKAM-240	15,000
Total			
November	11/6/2012	MEKKAM-12 repeat	15,000
	11/14/2012	MEUKAM-120	10,000
	11/20/2012	MEUKAM-132	10,000
	11/26/2012	MEUKAM-144	20,000
	11/29/2012	MEUJKAM-216	20,000
Total			
December	12/5/2012	MEOKAM-60 repeat	10,000
	12/12/2012	MEUKAM-96	20,000
	12/20/2012	MEUKAM-120 repeat	10,000
	12/28/2012	MEUJKAM-240	21,636
Total			**61,636**
Grand total			**869,636**

MEKKAM = government short-term treasury obligations , MEOKAM = government medium-term treasury obligations, MEUKAM = government long-term treasury obligations , MEUJKAM = government long-term savings treasury obligations.
Source: Ministry of Finance.

210. Transparency in the auction process for government bonds could be enhanced. Bids for government bond auctions are accepted in two formats: the bidder submits actual yield, or the bidder accepts the average yield as calculated by KASE, based on all bids submitted. However, as noted above, auctions can be announced at short notice and it is not uncommon for auctions to be cancelled post-auction if the Ministry of Finance does not accept the bids tendered. That is, if the market tries to influence yields at auctions, the Ministry of Finance cancels the auction. It was reported that a couple of auctions in 2012 were cancelled, with an average of 10%–15% of auctions cancelled in previous years. This may complicate cash flow management for market players and institutional investors. At the same time, government bond yields at auction do not reflect underlying market conditions because the auction can be cancelled should bids be considered too high.

211. The NBK acts as adviser to the Ministry of Finance in respect of government bond issuance but, unlike other jurisdictions, does not act as the government's agent for conducting primary auctions. Rather, the ministry directly submits the application for issuance of government bonds to KASE, which then conducts the auction. Although NBK has adopted the primary dealer framework for Treasury note auctions, the Ministry of Finance does not use primary dealers for its auctions. Rather, members of KASE—including banks, brokers, and accumulative pension funds—are permitted to submit bids at the auction. As no primary dealers are appointed in the government bond market, there is no KASE member is obligated to purchase government securities or maintain a secondary market in government bonds. Nor does the Ministry of Finance appoint market makers for government bonds. As a result, no institution is charged with maintaining secondary market liquidity in government bonds.

212. The supply of government bonds does not meet market demand. As seen in 2012, (Table 20) government bond auctions are typically in the order of T10 billion–T15 billion ($68 million–$102 million),[111] with monthly issuance of government bonds ranging from T61 billion–80 billion ($417 million–$542 million). Some observe that the country's strong resource base means it is not necessary for the government to issue debt to fund the budget deficit. Consistent

[111] Considerably smaller than Treasury note auctions at T30 billion–T200 billion ($203 million–$1,355 million).

with this, the government is concerned about the debt service cost associated with issuance of government bonds. Hence, the Ministry of Finance strategy is twofold, namely to (i) limit the volume of issuance and (ii) reject bids that are considered too high, notwithstanding that the yields reflect market supply and demand conditions.[112]

213. However, in addition to providing finance to government, government debt forms the foundation of the finance sector. In this regard it should be noted that government bonds are unique by virtue of their effective risk free status—critical to bank capital usage—and that they are the most liquid fixed income instrument. Risk management products and private sector debt instruments depend on an active market in government bonds for price discovery—a feature that confers on government bonds "benchmark" status. The government bond market is therefore not an isolated part of the financial system; rather, it is tightly integrated with other markets, including debt, equity, foreign exchange, and their respective derivatives. That said, excessive government borrowing through the debt markets will distort price signals. It is important to maintain balance in government credit demands.

214. The government bond market plays a key role in underpinning bond market growth as, in the early stages, it will involve more issuance and trading than the corporate bond market—both activities being essential to providing a strong profit base that will attract and maintain market intermediaries. As the government bond market grows, so does the experience and skill set of industry professionals—necessary conditions for the development of a corporate bond market. In this sense, the secondary government bond market also acts as a precursor to development of the corporate bond market, given the skills required to actively trade in government bonds. The strategy the Singapore government used in 1998 to develop the government bond presents a useful example (Box 3).

Box 3: Singapore Government Securities Market

In the decades preceding 1998, the Singapore state budget enjoyed annual surpluses in all but a couple of years, leaving no need for the government to issue bonds to fund the budget. But after of the Asian financial crisis in 1997/98 the government announced plans to develop Singapore as a financial hub for the region. The development of a benchmark government program was crucial to the success of this strategy.

Measures taken to develop the Singapore Government Securities (SGS) market included:

- extending the benchmark yield curve;
- establishing a public calendar of issuance;
- adopting an issuance program to build large, liquid benchmarks;
- establishing a repo facility to support the primary dealers; and
- providing a pool of securities from which primary dealers could borrow to cover their short positions arising from market-making activities

Starting in August 1998, the government began issuing 10-year SGS to extend the benchmark yield curve, where the size of SGS issues was increased in line with a pre-announced calendar. Other state entities, such as statutory boards and government-linked companies, were encouraged to tap the bond market for their funding needs. Various tax incentives were introduced, such as to encourage financial institutions to boost their debt teams and to base their bond origination, trading, and distribution activities in Singapore.

Guidelines on the non-internationalization of the Singapore dollar were relaxed to encourage greater

[112] The National Bank of Kazakhstan has rejected bids at Treasury note auctions since the fourth quarter of 2011 due to cost concerns.

nonresident participation in Singapore dollar (S$) capital markets. Issuance of S$-denominated bonds by foreign entities was promoted, where the proceeds were swapped into foreign currency—similar to many other developed markets. To widen the credit spectrum of foreign entities tapping the Singapore dollar bond market, issuance of both rated and nonrated bonds by foreign corporations and sovereigns was permitted. At the same time nonresident players were actively encouraged: the existing S$20 million ($15.9 million) consultation limit for SGS repos with nonresidents was lifted and banks were allowed to freely transact Singapore dollar interest rate derivative products with nonresidents.

The government also made efforts to boost the demand side of the debt market by enhancing the asset management industry. Steps were taken to increase the amount of funds managed in Singapore and to strengthen capacity within the industry.

The debt market grew significantly. Outstanding SGS rose from S$25.4 billion ($20.2 billion) in mid-1998 to $36.1 billion ($28.7 billion) at the end of 1999, up 33.5%. In 1999, nongovernment entities issued S$9.2 billion ($7.3 billion), more than double the amount raised in 1998, while Singapore statutory boards issued S$2.6 billion ($2.1 billion) in the 15 months from October 1998. Nonresidents also responded positively to the liberalization of Singapore dollar guidelines, and in 1998–1999, foreign entities issued more than S$4 billion ($3.2 billion), including international financial institutions, United States, and European corporations and financial institutions.

Based on regular dialogue with major market participants—and to further develop the SGS market—in 2000, additional measures were introduced to strengthen the market-making mechanism and improve price transparency. The measures focused on three aspects of the market:

1. Steps to boost the SGS repo market liquidity

   - To support the price-making function of primary dealers, the Monetary Authority of Singapore introduced an SGS repo facility, which is only available to primary dealers.[113]
   - Initially this facility was launched for a fixed pool of benchmark SGS bonds, auctioned to primary dealers through a daily repo auction, with the tenure limited to overnight repos only, with the aim of providing primary dealers with cover for short positions in benchmark issues arising from their market-making activities.

2. Building larger benchmark issue sizes to facilitate secondary trading

   - At the time, banks used a sizeable proportion of SGS issued to satisfy their minimum liquid asset requirements, in the process reducing the effective free float of SGS available to meet the needs of other investors and short-term traders, and stifling trading opportunities.
   - Demand for SGS had also increased from new players in the SGS market coupled with the growing use of SGS as a hedging instrument for the fixed rate liabilities of swap arrangers for nonresident issuers of Singapore dollar bonds.
   - To create larger, more liquid and tradable benchmark issues—and ensure a sizeable free float above minimum liquid assets holdings—the average benchmark issue was targeted to increase from typical sizes of about S$1.50 billion ($1.19 billion) to at least S$2.00 billion–S$2.50 billion ($1.59 billion–1.98 billion), subject to assessment of market conditions.*

3. Improving price transparency

   - In the early stages of market development, to ensure the primary dealership system functioned smoothly, the Monetary Authority of Singapore performed the role of an SGS broker for primary dealers. As the SGS market grew, much of the SGS trading was transacted through the authority

[113] A key role of primary dealers is to quote two-way prices under all market conditions—essential in maintaining liquidity in the government bond market. In the course of their price-making activities, primary dealers may have resultant short positions in specific government bond issues and may not always be able to cover these positions by borrowing the physical security, rather than having to buy outright from the market.

as broker, which is not desirable for the long-run growth of the market as the Monetary Authority of Singapore' brokered prices are not transparent to all market participants. Such a process also undermines interdealer market-making as it cannibalizes activities that should have gone to commercial brokers. The Monetary Authority of Singapore therefore ceased performing the SGS broking role.

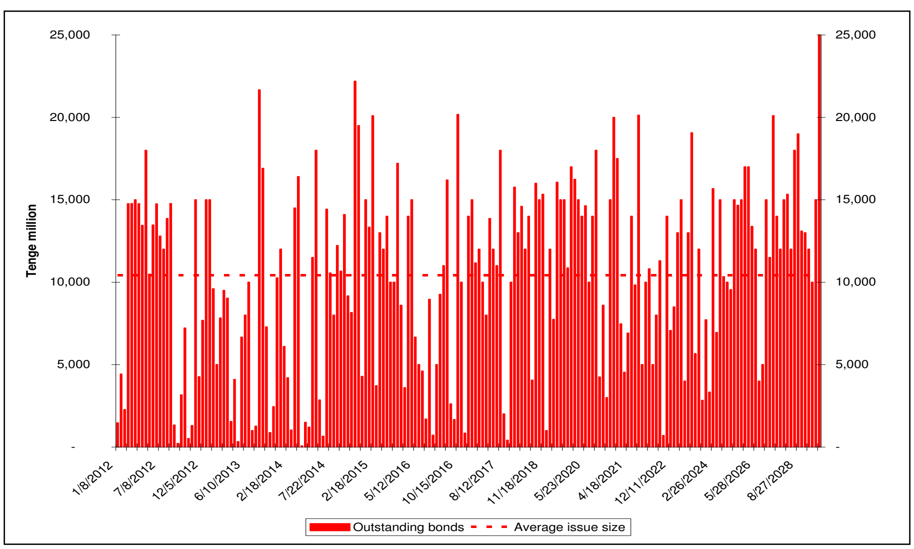
- With the bulk of SGS trading transacted through commercial brokers or direct dealings between primary dealers, price discovery became more transparent and efficient. With greater participation by primary dealers and secondary market participants, bid-ask spreads in the broking market narrowed following the initial adjustment period, which was associated with a dip in market turnover.

The above measures put the SGS market on a sound footing and eventually helped facilitate the growth of Singapore as a financial hub.

Note: All US dollar equivalents are based on S$1.26 to the US dollar.
* The intention in aggregate was to increase total SGS free float substantially from the current level of about S$12.0 billion ($9.5 billion).
Source: Monetary Authority of Singapore (http://www.mas.gov.sg/) and the Frankfurt School of Finance & Management.

215. The absence of benchmark issues impeding the development of the bond markets. As of 1 January 2012, there were 199 issues of government bonds outstanding in maturities out to 2031, for a total volume of about T2.07 trillion ($14.09 billion) (Figure 4). Some bonds mature within days of other bonds, and in some cases up to 4 issues mature in any given month. Issue sizes range from T1.47 billion–T25.00 billion ($9.9 million–$169.0 million) with an average issue size of T10.42 billion ($70.60 million). To date, the Ministry of Finance has not issued taps on outstanding issues, although there is no impediment to reopening issues. Indeed, the Ministry of Finance planned to reopen issues in 2012 (see Table 20), to increase the size of issues, for example, from T15 billion ($102 million) to total volume outstanding of T40 billion ($271 million).

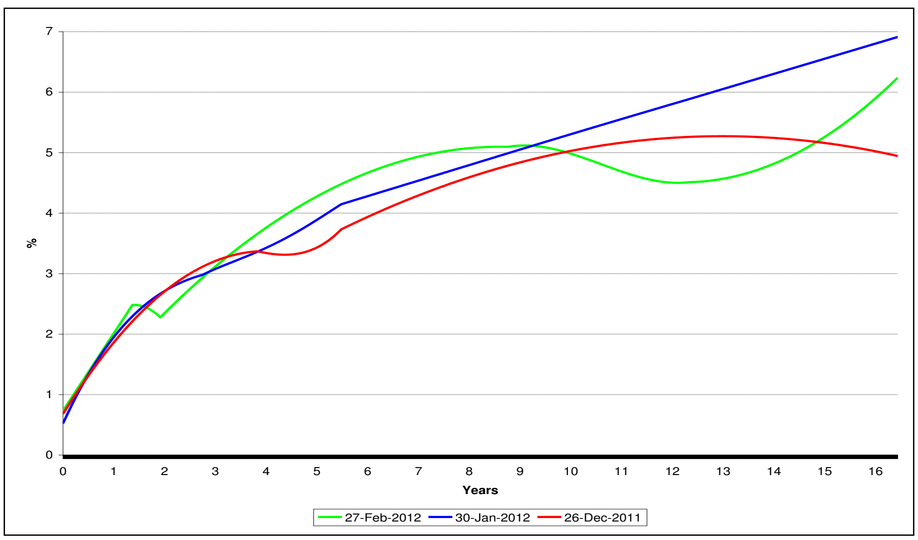
Figure 4: Government Bonds Outstanding as of 1 January 2012 by Maturity (tenge million)



Source: Ministry of Finance. Unpublished.

216. On a related note, there is no benchmark yield curve to serve as the risk-free pricing reference for all other bond issues as well as to facilitate mark-to-market activities.[114] In the absence of a benchmark yield curve—and with limited secondary market trading and, hence, observable prices—KASE has devised a methodology based on polynomial equations to enable it to publish weekly average yields each Monday (Figure 5). The methodology is backward looking in that, where there have been no trades in long-term bonds over the past week, for example, KASE inputs the results of the three most recent auctions in long-term bonds. It is understood that, there may be monthly auctions in long-term bonds. It therefore follows that the results of auctions occurring more than 3-months previously are included in calculating the current yield for long-term bonds, irrespective of movements in other variables such as the exchange rate or inflation rate during this time. However, prices for government securities observed in the primary and secondary markets are not necessarily reflective of market conditions—a constraint given the FSC's requirements for certain types of investors (such as accumulative pension funds, insurance companies, and banks) to hold government bonds in their portfolios. The lack of trades in the secondary market for government bonds is often observed, while prices in the primary market do not necessarily reflect fair prices. The combination of these factors results in yield curves that tend to demonstrate kinks and/or distorted inflection points.

Figure 5: KASE Yield Curve—Selected Dates



Source: Kazakhstan Stock Exchange. Unpublished.

217. The more sophisticated market players have developed their own yield curves. However accumulative pension funds prudential requirements specify that the yield curve KASE publishes each Monday must be used to calculate the mark-to-market value of their portfolios. Given the observed distortions in the yield curve, the integrity of portfolio valuations published by accumulative pension funds is questionable.

218. **Corporate Bonds.** Capital market activities should be based on a rational assessment of risk and return for any given securities investment. Such assessment is only possible where there is appropriate open and full disclosure of all relevant material information. It follows that a well-developed bond market must be underpinned by strong corporate governance. Disclosure

[114] No asset can be considered truly risk free, although government bonds are seen as filling this role given the government's ability to print currency.

and corporate governance, coupled with an unambiguous legal framework, will give issuers the confidence to raise funds in the domestic capital market and provide long-term investors the assurance to commit their funds to the country. It is therefore essential that the capital market's regulatory regime ensures that such information is widely available in the public domain, with priority given not only to the quality of information, but also to its timely disclosure.

219. Just as equities are listed under three categories on KASE, so are corporate bonds: (1) rated, (2) nonrated, and (3) buffer.[115] Within the nonrated category, there are two subcategories: (i) issues where the borrower has good financials, and (ii) issues with weaker financials, primarily associated with infrastructure companies. A total of 239 issues are listed from 70 issuers, with the composition of each of the categories being (i) 137 issues from 44 issuers in category 1; (ii) 72 issues from 19 issuers in the nonrated first subcategory; (iii) 27 issues from 18 issuers in the nonrated second subcategory; and (iv) 3 issues from 3 issuers in category 3.[116]

220. More than 50 corporate bond issues from more than 30 issuers defaulted during 2009–2010. At present, KASE reports a total of 33 companies in default on their securities, of which 9 are still listed (as of 1 November 2012).[117] For securities listed in the buffer category,[118] the issuers of the 3 securities listed in this category have not yet completed arrangements to exit the buffer category. The rest of the bonds that had ceased paying interest are not listed in the buffer category because (i) the fees were not paid and the securities have been excluded from KASE official list; and/or (ii) the debt has been settled through a debt restructuring. Being listed in the buffer category has implications for investors in these securities (mostly accumulative pension funds) as it is understood that KASE will continue to post weekly prices for mark-to-market purposes.

221. Regulatory requirements are reducing the demand for corporate bonds and restricting the number of enterprises that can issue in the domestic bond market. One example is regulations associated with credit ratings, in which the regulator only acknowledges ratings provided by international credit rating agencies.[119] This is true even though there are three local agencies in Kazakhstan. But KASE does acknowledge local rating agencies. Due to the higher fees charged by international rating agencies, it is estimated that only about 10% of Kazakhstan's enterprises obtain a rating from an international agency, thereby limiting the number of potential issuers. In addition, the international rating agencies do not normally assign a rating to relatively small companies, such as with earnings before interest, taxes, depreciation and amortization less than $100 million, even though the companies may have strong fundamentals. Furthermore, although the regulator allows pension funds and insurance companies to invest in bonds rated by the local agencies—calling such bonds "unrated" for prudential norms purposes—the bonds must be weighted at a much higher risk for capital adequacy or liquidity purposes. Thus, regulations require that pension funds must provision 100% against corporate paper, rising to 150% if the issue is only rated by a local rating agency,

[115] See order No. 04.2-09/119 of the Chairman of the Agency of the Republic of Kazakhstan on Regulation of Activities of the Regional Financial Center of Almaty dated May 8, 2008: On Establishment of Requirements for Issuers, whose Securities are Intended for Inclusion or Included into the List of Special Trading Floor of the Regional Financial Center of Almaty, and for Such Securities.

[116] See the Kazakhstan Stock Exchange, http://www.kase.kz/en/ticker. Securities in different categories of the official listing may be issued by the same issuer, so that the number of issuers in each category sums to more than the total number of issuers shown.

[117] The remaining 22 companies have been delisted.

[118] The regulations permit securities in default to be transferred to the buffer category in certain circumstances: (i) noncompliance of securities and their issuers' requirements set out in paragraphs 10 and 11 of these requirements; (ii) the issuer defaults on payment of interest on its obligations (excluding the most recent coupon period); and (iii) the obligations of the issuer are under restructuring.

[119] Standard & Poor's, Fitch Ratings, and Moody's Investors Service all rate local issuers.

in addition to which the rating must be stronger than single-B. This makes it expensive for pension funds to hold these assets rather than holding government bonds, thereby reducing demand and/or increasing the required return for a bond that would otherwise have had the same characteristics except for the rating.

222. Rating restrictions exist for both resident and nonresident issuers. Nonresident issuers with a rating lower than "A-" (by Standard & Poor's, Fitch Ratings, and Moody's Investors Service) cannot register its bond with the local regulator, which effectively causes the local investor to seek such foreign high-yield exposure through trading platforms other than the KASE. In practice this means that virtually no borrowers from the Russian Federation or the Ukraine can issue in Kazakhstan's domestic market.

223. It was observed that the disclosure requirements for listing approval on KASE are considered more onerous than the level of disclosure specified by the FSC for the prospectus. Prospective issuers must file a prospectus with the FSC, where the time taken to obtain pro-forma registration is typically no less than 30 days. The approval process was not considered transparent or consistent in the additional details requested. Having obtained FSC approval the Investment Memorandum (a separate document from the prospectus) must be filed to support listing on KASE.[120] As with FSC approval, it usually takes around 30 days to obtain listing approval. It therefore takes a minimum of 2 months to obtain the necessary approvals. In spite of the arduous approval process for new issues, market players do not feel ongoing disclosure requirements are adequate in that material changes are not disseminated in a timely manner. At the same time, it appears that the regulations forbid private placements.

224. Other requirements associated with listing on KASE include (i) a credit rating from one of the top 3 international credit rating agencies, (ii) the documents for getting consent to list are available in Russian, and (iii) documents to support ongoing disclosure requirements. KASE also imposes rating restrictions, but these are considered less onerous than those of the FSC. In 2010, KASE listing requirements were amended to specify that the minimum acceptable rating for listing is C1 by RFCA Rating Agency,[121] which market participants consider too strict and which prevents many local companies from issuing.

225. The recent law on amendments and additions to some legislative acts of the Republic of Kazakhstan on regulation of banking and financial institutions in terms of risk minimization has raised concern. Under the existing law, trading of derivatives executed by banks can be on-exchange, with the exception of derivatives that are specified in the previous act of 2007. The amendment includes a requirement for banks to conclude deals involving state securities and non-state securities and with a wide range of exceptions for derivatives in the secondary market through the stock exchange only. Previously, a new issue in the local market could be placed OTC.[122] In effect, the amendment will eliminate the OTC market as all new issues must be placed through KASE if they are to be listed. Globally, around 95% of fixed income market trading is OTC, although since the global financial crisis there is a trend in developed markets to move more trading onto exchanges. Fixed income securities tend, by nature, to be non-standardized whereas securities traded on-exchange are standardized. Examples of the latter are futures contracts and the former, forwards. Requiring all trading to take place on-exchange may stymie development of the derivatives market.

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[120] Of the two documents, the Investment Memorandum is key for listing, and generally has stricter information disclosure requirements.

[121] Previously, there were only two categories on KASE: rated and unrated securities.

[122] One market player estimated that, as of December 2011, around 20% of new issues were placed through KASE.

226. One concern raised among some market participants was that there were too few corporate bond issues from reputable borrowers in the market. One possible explanation for this could be the differential interest rates between corporate loans and bond issues. Underwriting of new issues is on a best-efforts basis, with fees ranging from 30 basis points to 70 basis points. Transaction costs associated with issuance include those for listing[123] and underwriting. The former is estimated at around $77,000 for year one, and the latter at $45,000 —$1.05 million for a $150 million issue—with ongoing listing fees of $22,000 and market makers fees of $12,000 per year.[124] There will also be fees for the registrar, depository, and trustee in the order of $120,000–$180,000 a year. It is estimated that a 5-year corporate bond issue would cost about 10%–12%, where a 5-year bank loan for a comparable credit would be 7%–8%. The more attractive rates on corporate loans may be the result of directed lending; for example, under the government support program in 2011 banks loans to specific companies were eligible for a government subsidy of 7%.[125] At the same time, there is no credit culture; bank lending is mostly collateralized rather than based on cash flow.

227. While the requirements are the same for resident and nonresident issuers, there are perceived barriers to entry for foreign issuers in the domestic bond market. From the supply side, the regulations require that the issuer is a Kazakhstan entity, which makes it difficult for the (nonresident) parent company of a local subsidiary to issue onshore. The regulator does not allow issues by foreign borrowers rated less than A-. And the prospectus, investment memorandum, and documents supporting the listing on KASE must be provided in Russian and Kazakh—where the time taken for translation of documents adds to the time taken to obtain approval. Given the onerous approval process, the need to incur extensive translation costs, and all-up transaction costs, many foreign issuers of tenge bonds have elected to issue in the Eurobond market rather than the domestic market.

228. In line with the average weekly prices for government bonds published each Monday (Figure 5), KASE also publishes average prices on all listed corporate bonds. While there is sound logic in publishing prices on a weekly basis so investors can mark-to-market portfolios, due to insufficient liquidity in the secondary market, securities may not have traded over the previous week or even over the past several weeks. In the absence of sufficient observed secondary market prices due to a lack of continuous trading, derived secondary market prices may not reflect underlying market conditions. This is compounded by the fact that bonds listed in the buffer category are in default. Market operators report that in some cases there can be discrepancies of 5%–6% between (derived) yields published by KASE versus yields observed in international markets for dual-listed Eurobonds, where the latter are based on observed (offshore) trades. Perhaps there is some way to incorporate the yields of Eurobonds based on actual prices in the KASE secondary market prices.

229. The Kazakhstan Mortgage Corporation (KMC) has issue mortgage backed securities in the domestic market. Although all issues but one were securitized, unlike typical mortgage backed securities deals in developed markets, the transactions were not structured so as to make the collateral bankruptcy remote. Thus, no special purpose vehicle structure was used—rather, KMC issued the issues directly, and were structured as conventional collateralized bonds. Collateral backing for the bonds was 100%, that is, the value of the underlying collateral was the same as the nominal value of the bond, where the value of the underlying collateral was subject to semi-annual valuation by an independent auditor. If appropriate, KMC adds additional

[123] Initial admission fee (to be set against the admission fee where securities are subsequently listed), admission fee, and annual listing fee.

[124] KASE requirements include at least one market maker for each listed security, notwithstanding there are no market makers for government bonds.

[125] Companies involved in manufacturing for export, start-up infrastructure, or under a restructuring program.

mortgages (or other highly liquid assets) to the collateral register in order to maintain 100% cover, and replaces maturing or delinquent collateral with new mortgages. That said, it was observed that issuance of mortgage backed securities is compromised by difficulties in enforcing collateral.

230. **Sukuk Bonds.** There is strong interest at the government level in favor of the introduction of Islamic financing techniques in the domestic market. Following a series of media announcements about government plans to issue debut sovereign Islamic securities, also known as *sukuk*, Kazakhstan amended legislation to allow for greater use of Islamic financing.[126] The earlier legislation provided that only an Islamic bank and certain state holding companies as well as their wholly-owned subsidiaries could act as an originator of Islamic securities [127] Privately-owned companies (except for Islamic banks) could not serve as originators. Under the new amendments, this limitation has been abolished. Now a legal entity resident in Kazakhstan, such as companies formed under Kazakhstan law, may issue Islamic securities through an Islamic special finance company. Under the amendments, such legal entities will have to comply with requirements of the central bank that have yet to be promulgated.

231. The amendments provide, among other things, a legal framework for the issuance of Islamic securities by the Government of Kazakhstan**.**[128] In particular, they appear to be aimed at facilitating sovereign issuance of Islamic securities to finance toll roads in Kazakhstan. The amendments became effective in August 2011, and it is expected that the government and the central bank will adopt several sets of implementing resolutions. For the first time in Kazakhstan, the amendments permit a state body (the Ministry of Finance) to act in the capacity of a special purpose vehicle in connection with the issuance of securities.

232. Although the regulator recently extended the legal framework originally introduced in 2009[129] for issuing Islamic products,[130] this was restricted to only two types of instruments: rent certificates and participation certificates. At the same time, the framework for Islamic instruments printed outside Kazakhstan by local issuers is not clear. Additionally, the legal framework for the local Sharia Council has not been established; for example, there is only one Kazakh presently qualified as a member of the Sharia Council.[131] Market operators believe that the regulator should pronounce on a clear definition for the Sharia Council in order to move this project forward.

233. While some market players are working to prepare for *sukuk* transactions, it is generally considered that the plan to introduce Islamic finance is politically motivated. Market consensus is that there will be limited demand for *sukuk* unless the issuer is either sovereign or quasi-sovereign, there are good opportunities for regulatory arbitrage, and/or the securities meet rate-of-return criteria.

[126] Budget Code of the Republic of Kazakhstan dated 4 December 2008; Law dated 2 July 2003: On Securities Market; Law dated 17 July 2001: On Motor Roads.

[127] A national holding company (currently National Holding ’KazAgro’) and a national management holding company (currently Samruk-Kazyna) and wholly owned subsidiaries of Samruk-Kazyna.

[128] Law of the Republic of Kazakhstan, dated July 22, 2011: On Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Organization of Islamic Financing.

[129] Law on Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Organization and Activity of Islamic Banks and Organization of Islamic Financing dated 12 February 2009.

[130] See Law of the Republic of Kazakhstan, dated July 22, 2011: On Making Changes and Amendments to Certain Legal Acts of the Republic of Kazakhstan Concerning Organization of Islamic Financing.

[131] To qualify as a member of the Sharia Council it is necessary to study Islamic theology in the Persian Gulf countries for 7–10 years (to masters or doctorate level).

234. **Derivatives Market.** KASE has attempted to develop a derivatives market, most recently in 2010. Then, the Rules for Stock Exchange Trade in Futures Contracts were agreed by the FSC in July, the Rules for Conducting Clearing Activities on the Futures Contract Market in October, and the Provisions on the Reserve and Guarantee Funds in September. All documents came into force on 20 October 2010 and replaced the previous Rules for Stock Exchange Trade and Settlements on Futures Contracts, as well as the specifications of previously existing futures. Following the endorsement of relevant documents and an extensive marketing campaign,[132] KASE started online trading in futures on tenge/US dollar and on the value of KASE Index in an online regime on its trading floor in December 2010. Trading in futures contracts on KASE over 2011 totaled T2.9 billion ($19.7 million).[133] Market consensus was that banks were not especially interested in on-exchange futures trading since price transparency makes it difficult to price in a margin for credit risk when dealing with end-users, that is, clients expect to receive the price published on KASE. That said, efforts to bring all derivatives trading onto KASE will do little to promote development of the derivatives market.[134]

2. Demand for Securities

235. Unlike other developing countries, considerable effort has been put into building demand for securities in Kazakhstan, starting with the implementation of major pension reform in 1998. Table 21 sets out the investment portfolio structure of the key institutional investors in the securities markets, from which it can be observed that accumulative pension funds dominate the demand side of the markets. Insurance companies lag accumulative pension funds, with a considerably smaller investment portfolio. While demand for insurance is usually slow to build in developing markets, in Kazakhstan it is only a matter of time before asset demand from accumulative pension funds is mirrored in demand from insurance companies as retirees look to purchase life insurance products in the form of annuities.

Table 21: Investment Portfolio Structure of Selected Investors
($ million, on 1 January 2012)

	Accumulative Pension Funds	Insurance	Banks	Total
State securities including	7,821.1	332.5	5,869.3	14,022.9
Ministry of Finance securities	7,236.2	283.9	3,654.3	11,174.4
National Bank of Kazakhstan notes	546.9	31.2	2,180.5	2,758.5
Municipality securities	38.0	17.4	34.5	90.0
Corporate securities of Kazakhstan issuers	4,908.0	682.8	2,124.9	7,715.7
Equities	988.4	27.0	272.3	1,287.7
Bonds, including:	3,919.6	655.8	1,852.7	6,428.1
nominated in foreign exchange	178.7	...	...	178.7
nominated in tenge	3,740.8	...	...	3,740.8
Bank deposits	1,199.1	623.5	...	1,822.7
Derivatives	(6.4)	0.0	...	(6.3)
Corporate securities of foreign issuers	989.2	106.4	714.4	1,810.0
Equities	125.0	33.8	18. 1	176.9
Bonds	864.2	72.6	696.3	1,633.1

[132] These included a game on trading in futures contracts where participants had a chance to conduct transactions with cash-settled futures on the rate of the US dollar and on the KASE Index, to demonstrate the capacity of working with derivatives in the trading system and to test the software and equipment in this segment of the market.
[133] Kazakhstan Stock Exchange. http://www.kase.kz/en/fut
[134] Recent amendments to the Law on Risk Minimization.

	Accumulative Pension Funds	Insurance	Banks	Total
Units of foreign investment funds	...	...	...	...
international financial institutions securities	629.7	62.9	297.5	990.2
State securities of foreign issuers	858.8	48.2	109.7	1,016.6
Refined gold	856.4	...	...	856.4
Reverse repo	...	65.7	...	65.7
Investment funds' units	...	2.6	...	2.6
Total	**17,256.0**	**1,924.5**	**9,115.8**	**28,296.4**

... = not available
Source: Committee for the Control and Supervision of the Financial Market and Financial Organizations (FSC) of the National Bank of Kazakhstan. 2012. "Current Status of the Securities Market of the Republic of Kazakhstan as of January 1, 2012." http://www.afn.kz/attachments/119/269/publish269-1093528.pdf.

236. Given the importance of Kazakhstan government bonds as an asset class, it is also instructive to review the composition of demand for these securities (Table 22). In the primary market, two investor categories account for close to 80% of total turnover: accumulative pension funds account for around 42% and second-tier banks for 37.5%. In the secondary market for government bonds, second-tier banks and brokers account for almost equal shares, at 41.2% each, with pension market entities accounting for the residual.

Table 22: Turnover in Government Bonds by Main Investors for 2011 ($ billion)

	Primary Market	Secondary Market
Second-tier banks	1.01	2.97
Second-tier bank clients	1.62	…
Clients of brokerage and dealer companies	0.26	1.42
including individuals	0.01	0.54
Brokers and dealers	0.04	0.38
including individuals	…	...
Pension Assets Investment Management Organisation (PAIMO) at the expense of pension assets	1.63	…
Pension market entities	...	1.47
Total	**4.57**	**6.23**

… = not available
Source: Kazakhstan Stock Exchange. 2011. Factbook. Almaty.
http://www.kase.kz/en/page/show/factbook-2011

237. **Pension Funds' Demand for Investable Products.** In implementing pension reform, the government adopted the three pillar structure followed by Chile.[135] By their very nature, pension fund liabilities are denominated in local currency and are of long duration.[136] To maintain a commensurate risk profile, it therefore follows that when developing appropriate investment strategies pension fund managers should focus on diversification, duration, and denomination. Asset portfolios should contain a mix of the following:

- equities
- government bonds
- corporate bonds

[135] Chile introduced pension reform in 1981 using a model that has been extensively followed by other developing countries.
[136] Depending on contributors' longevity, the duration of pension fund liabilities can range up to 70 years.

- structured fixed income products, such as asset-backed securities (mortgage-backed securities or collateralized debt obligations) and infrastructure bonds;
- real estate
- foreign currency assets.

238. It is instructive to consider the evolution of investment guidelines in Chile since the inception of reforms in 1981 (Box 4).

Box 4: Republic of Chile—Pension Reform

At the outset, pension funds in Chile were required to invest 100% of assets in fixed income bonds, with varying percentages allocated to government, quasi-government, and corporate bonds (Table 23). In 1985, the funds were permitted to invest up to 30% in equities. Investment in foreign assets was not permitted until 1990, at which time authorities specified a limit of 1%, to increase annually by 1% for the ensuing 5-years, with a further increase to 20% in 1999. In 2002, Chile adopted a multi-portfolio approach whereby pension funds must offer four different funds, each with a different risk/reward profile ranging from 5% equity (Fund E) with 20% increments to 60% equity (Fund B). The regulations also allowed the pension funds to (voluntarily) offer a fifth fund with an equity share of up to 80% (Fund A). At the same time, the maximum global limit for offshore investment has been progressively increased,[137] most recently in 2008 from 45% to 60% depending on the funds' risk/reward profile.[138] From 1994, pension funds were permitted to invest in hedging instruments.

Source: Superintendence of Pension Funds Administrators of Chile.

239. In January 2012, a multi-portfolio system was introduced in Kazakhstan requiring pension assets to be invested in portfolios adopting different investment strategies as follows:

- conservative—assets primarily invested in government bonds.
- moderate—up to 30% assets invested in equities and corporate bonds.
- aggressive—investment bearing higher risk characteristics.

240. Under this system, accumulative pension funds must now maintain two investment portfolios in respect of pension savings, where the distinguishing feature is the absence of equities in the conservative portfolio.[139] Investment guidelines for the moderate portfolio include (i) no less than 20% in state (government) securities, (ii) less than 80% in tenge-denominated corporate bonds, (iii) no more than 30% in equities, (iv) less than 10% in precious metals, and (v) up to 30% in foreign exchange assets, although there are (short-term) exemptions allowing up to 40%. In the latter category, holdings of foreign investments are limited not only by the currency position, but also by the requirement that the asset must be rated higher than BBB- by an international credit rating agency.

241. Since 1998, assets under management for accumulative pension funds have grown continuously, and were estimated at $17.9 billion as of January 2012, about 10% of GDP. Monthly inflows to the pension funds from some 8 million contributors are running at about T30.0 million ($203.3 million), giving a growth rate of assets under management in the order of 20%–25%. It is predicted that retirees—withdrawals from accumulative pension funds—will only match new contributors in 2025, at which time assets under management are forecast to reach $70 billion, with growth estimated to be flat from this point through to 2070. With such a large pool of assets under management, it is no surprise that demand for securities in Kazakhstan is

[137] Permitted assets include time deposits, bonds, convertible bonds, and equities, but exclude real estate.
[138] Fund A can invest up to 80% in foreign assets.
[139] The third, aggressive portfolio is to be introduced in 2015, and will not be mandatory.

dominated by the pension funds. However, although implementing pension reform was a key factor in developing the demand side for the domestic securities market, unfortunately there was not a corresponding focus on the supply side, as a result of which there is a large and growing demand-supply imbalance.

Table 23: Republic of Chile: Evolution of Permitted Ranges for Investment Limits of Pension Funds (%)

<table>
<tr><th>Instrument</th><th>1981</th><th>1985</th><th colspan="2">1989</th><th colspan="2">1990</th><th colspan="2">1994</th><th colspan="2">1996</th><th colspan="2">1999</th></tr>
<tr><td>State issued</td><td>100%</td><td>100%</td><td colspan="2">50%</td><td colspan="2">45%</td><td colspan="2">35%–50%</td><td colspan="2">35%–50%</td><td colspan="2">35%–50%</td></tr>
<tr><td>Mortgage notes</td><td>40%–100%</td><td>40%–100%</td><td colspan="2">40%–100%</td><td colspan="2">40%–100%</td><td colspan="2">35%–50%</td><td colspan="2">35%–50%</td><td colspan="2">35%–50%</td></tr>
<tr><td>Fixed income issued by financial institutions</td><td>40[a]%–100%</td><td>40%[a]–100%</td><td colspan="2">40%[a]–100%</td><td colspan="2">40%[a]–100%</td><td colspan="2">30%–50%</td><td colspan="2">30%–50%</td><td colspan="2">30%–50%</td></tr>
<tr><td>Bonds from public and private corporations</td><td>60%–100%</td><td>30%–100%</td><td colspan="2">30%–100%</td><td colspan="2">30%–100%</td><td colspan="2">30%–50%</td><td colspan="2">30%–50%</td><td colspan="2">30%–50%</td></tr>
<tr><td>Stocks from open corporations</td><td>Not allowed</td><td>10%–30%</td><td>...</td><td rowspan="3">10%–30%</td><td>10%–30%</td><td rowspan="3">20%–40%</td><td colspan="2">30%–40%[b]</td><td colspan="2">30%–40%</td><td colspan="2">30%–40%</td></tr>
<tr><td>Real estate corporate stock</td><td>Not allowed</td><td>Not allowed</td><td>...</td><td>10%–30%</td><td colspan="2">10%–20%</td><td colspan="2">10%–20%</td><td colspan="2">10%–20%</td></tr>
<tr><td>Stocks from open corporations (concentrated)</td><td>Not allowed</td><td>Not allowed</td><td>10%</td><td>10%–30%</td><td colspan="2">...</td><td colspan="2">...</td><td colspan="2">...</td></tr>
<tr><td>National investment funds</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">10%–20%</td><td colspan="2">5%–10%</td><td colspan="2">5%–10%</td><td colspan="2">5%–10%</td></tr>
<tr><td>International investment funds</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">3%–6%[c]</td><td colspan="2">3%–6%[c]</td></tr>
<tr><td>Fixed income foreign instruments</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">1%[d]</td><td>6%–12%</td><td rowspan="2">6%–12%</td><td>6%–12%</td><td rowspan="2">6%–12%</td><td>10%–20%</td><td rowspan="2">10%–20%</td></tr>
<tr><td>Variable income foreign instruments</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">Not allowed</td><td>3%–6%</td><td>3%–6%</td><td>5%–10%</td></tr>
<tr><td>Hedging instruments</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">5%–15%</td><td colspan="2">5%–15%</td><td colspan="2">10%–25%</td></tr>
<tr><td>Others approved by Central Bank</td><td>Not allowed</td><td>Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">Not allowed</td><td colspan="2">1%–5%</td><td colspan="2">1%–5%</td><td colspan="2">1%–5%</td></tr>
</table>

... = data not available
[a] The limit is reduced to 30% if the duration is shorter than 1 year.
[b] The distinction between corporations with concentrated property and unconcentrated property was eliminated.
[c] This limit is joint with variable income investment abroad.
[d] 1% limit for 1- year was established, increased by 1% each year up to 5 years. After the fifth year it was supposed to be increased to 10%. It remains at 1%.
Source: Superintendence of Pension Funds Administrators.

242. Notwithstanding the investment guidelines, specified market participants, including managers of accumulative pension funds, commented that investment strategies are heavily influenced by the need to comply with regulatory guidelines on investment risk. These guidelines are described by two coefficients: (i) K1 which ensures that accumulative pension funds have adequate capital as measured by liquid assets less liabilities as a proportion of the risk-weighted value of assets for both the pension fund owner and accumulative pension funds;[142] and (ii) K2, which requires that if the fund's performance over a 5-year rolling period is more than 15% below the weighted average return of all accumulative pension funds for the period, an accumulative pension fund tops up either reserves or individual contributors.[143] Despite investment guidelines specifying a 20% minimum holding of government securities, as a result of the prudential guidelines, more than 45% accumulative pension fund assets are invested in government securities (Table 21). Bearing in mind that this category of investor's accounts for around 42% turnover in the primary market (
Table 22), it is not unreasonable to suggest that the current prudential guidelines for accumulative pension funds actually create a sizeable pool of captive investors for government bonds.

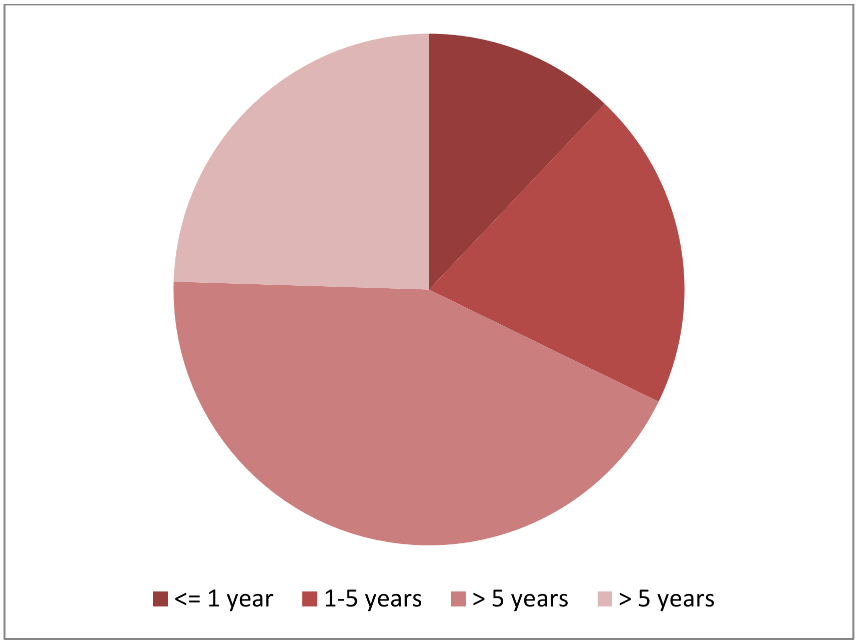
243. More than 45% of accumulative pension fund assets are invested in securities issued by the government (Table 20). Given market operators comments about the mismatch between supply and demand for government bonds—and taking into account the investor profile for government securities[144]—it is interesting to consider the 2012 auction calendar for government bond issuance. About one-third of issuance planned for 2012 is in maturities shorter than 5 years. Of the remainder, 25% of long-term issuance is specifically targeted to accumulative pension funds (MEUJKAM), while the remaining issues are standard long-term government bonds (

[142] Liquid assets less liabilities as a proportion of the risk-weighted value of assets for both the pension fund owner and accumulative pension funds was recently increased from 10 to 25, or 4%.
[143] If performance is 15%–30% below the weighted average, accumulative pension funds must top up reserves; if it is more than 30% below the weighted average, individual contributors must be topped up.
[144] Typically, banks and mutual funds purchase government bonds in maturities up to 5-years while pension funds and insurance companies tend to purchase bonds with maturities longer than 7 years.

Figure 6). Monthly issuance of MEUJKAM is forecast to be T17.8 billion ($120.6 million), around T12.2 billion ($82.7 million), or 41% below estimated monthly contributions to accumulative pension funds. The funds are free to submit bids at auctions of other long-dated government bonds (MEUKAM), but these are fixed rate securities and there is no mechanism available to hedge the interest rate risk. Fund managers also observed that other market players bid for MEUKAM at auction conscious of the backstop bid from accumulative pension funds.

244. The net result of this demand-supply imbalance is that yields on government securities are low. Yields on government bonds are around 3.5%–4.0% on 5-year maturities and 5.9% on 10-year—and are not necessarily reflective of conditions in the real economy. With annual inflation in the order of 7.0%–8.0%, there are negative real yields on government bonds of at least 3.5% in the medium term and 1.0% in the longer term. For this reason, plus the combination of large government bond portfolios and the need for accumulative pension funds to demonstrate returns in excess of inflation, there is demand from accumulative pension funds for any assets that yield a positive real return.

Figure 6: Ministry of Finance—State Securities Issue Plan for 2012 by Security Type



Source: Ministry of Finance. 2012. Plan for issue of government securities for 2012. Astana. http://www.minfin.gov.kz/irj/portal/anonymous?NavigationTarget=ROLES://portal_content/prototype_mf/roles/com.saprun.mf_anonymous_roles/com.saprun.mf_anonymous_ru/BudgetExecutionAndStatistics_Folder/StateObligations_Folder/plan_vypuska.

245. Regulations curb secondary market trading. For example, accumulative pension funds are only permitted to buy or sell securities at prices in line with KASE weekly average weighted yields or better. Thus, if accumulative pension funds wish to buy in the secondary market, the yield must be no lower than the KASE weekly rate; if they wish to sell, the yield can be no higher than the weekly average rate. This restriction creates two problems: (i) trading levels must be in line with KASE weekly average rates that are often not reflective of market conditions, and (ii) the dominant investor category is only permitted to trade at specified levels. This contributes to the poor liquidity in the secondary market.

246. In establishing the regulatory guidelines for pension funds, the government is mindful of its (potentially large) liability consequent on the government guarantee that pension fund contributions are inflation protected. That is, the balance at retirement is guaranteed to be no less than the inflation-adjusted values of all contributions over the contributor's lifetime. However, in guaranteeing individuals a real return on their pension, the government has created a contingent liability, the value of which is inversely related to accumulative pension fund returns. It may well be that the regulatory guidelines, while attempting to cap this guarantee, are actually compounding the government's problem by encouraging accumulative pension funds to invest in government securities earning a negative real return.

247. On a related note, mindful of the need to minimize the debt service cost, the Ministry of Finance keeps a tight rein on the volume of government bonds issued. However, in applying this strategy it would appear that the inflation protection aspect of the pension system has not been taken into consideration. It could be argued that it is in the interest of government to increase issuance of government bonds to underpin the development of the securities market—even if it does mean paying market rates of interest on the securities—since, at the end of the day, the government will have to compensate retirees for any negative real return on accumulative pension fund assets. Essentially it could be described as a cash flow issue—either the

government pays rates of interest in line with inflation now or it compensates retirees in the future for any negative real returns.

248. A total of around 77% of accumulative pension fund assets are invested in fixed income securities issued by domestic and offshore borrowers—around 23% in other Kazakhstan corporate bonds and close to 9% invested in the corporate bonds of foreign issuers and international financial institutions (Table 21). With such a bias towards fixed income securities—and given the absence of derivatives in accumulative pension fund portfolios—it follows that accumulative pension funds are heavily exposed to interest rate risk.

249. At the same time, the low level of free float compromises the pension funds, which are the dominant institutional investors in Kazakhstan, with assets under management at end-2011 of reportedly $17.9 billion. The level of their net inflows—it was reported that estimated monthly inflows are around T30.00 billion ($203.32 million)—has implications for their investment opportunities in the domestic equity market: in particular, it limits their ability to accumulate domestic equities. Given the poor liquidity of the secondary market and the low free float on KASE, the size of pension funds makes it very difficult for these institutions to trade in the local equity market as the market immediately moves against them.

250. Accumulative pension funds are therefore faced with a scarcity of investible assets and, as a result, excess liquidity. Under these circumstances, and to enhance the country's infrastructure, the government may wish to consider the approach taken by Singapore to pension provision through the Central Provident Fund (Box 5). Giving contributors access to the balance in their respective accounts for mortgage financing would reduce accumulative pension funds' excess liquidity while creating demand for public housing, thereby strengthening the social fabric of the country. However, given the current (relatively low) balances in individuals' accounts, the government should consider increasing individual contributions from the current level of 10%—up to 15% for example—and should simultaneously introduce a matching mandatory contribution from employers.

Box 5: Singapore—Central Provident Fund

Although originally designed as a fully-funded compulsory savings scheme to provide post-retirement security, the role of the Singapore Central Provident Fund (CPF) has evolved over time in response to changing demographics, economic conditions, and Singaporeans' rising aspirations and expectations.

Legislated in 1955, the first liberalization in the use of CPF funds came in 1968 with the setting up of the Public Housing Scheme to help working class families buy subsidized public housing, using their CPF funds to pay their mortgages.[145] In 1981, the scheme was extended to allow funds to be used for private residential property; in 1986, funds could be used for investing in nonresidential property; and in the 1990s, CPF funds could also be used for upgrading costs. From 2002, limits were imposed on CPF withdrawals for housing to 150% of the value of the property, with this limit subsequently reduced to 120% over 5 years.

CPF-funded home-ownership has had wide ramifications, especially for the property market, and anomalies have surfaced. Many older Singaporeans are now "asset-rich, cash-poor", although this situation can be remedied by "trading down". It was also the case that the downward trend in property prices associated with the 1997/98 Asian financial crisis eroded the usefulness of property as a hedge against inflation, in the process affecting CPF's retirement objectives. The social objective of home-ownership may also change over time. The challenge for the Singapore government is to determine what limit there should be to the use of CPF funds for housing. There is a need to attain a delicate balance

[145] The balance in the fund supports the down-payment/deposit, with subsequent monthly contributions servicing ongoing mortgage payments.

between social and economic considerations in order to safeguard social cohesion without creating too much distortion or instability in the property market, especially given the role that property prices play in signaling the level of confidence in the Singapore economy.

Individuals' CPF funds can also be used in the provision of heath care, a liberalization that was introduced in 1984 when the Medisave insurance scheme was established as part of the National Health Plan. A new Medisave Account was set up to help CPF members save for hospitalization expenses for themselves and family members, especially in old age.

CPF has also been used by the government as a tool to assist macroeconomic management, with contribution rates being adjusted to reflect underlying economic conditions. For example, contribution rates peaked at 50% in 1985—25% each from the employer and employee—at which time, given the recession and loss of competitiveness due to relatively high wages, the government adjusted the employers' contribution to 10%, thereby lowering total contribution rates to 35%. Subsequently, contribution rates were adjusted to the long-term target of 40%—or 20% each from the employer and employee—only to be adjusted again in 1999 in the aftermath of the Asian crisis when the employers' rate was again reduced to 10%. From 2002, to increase the attraction of older workers, the employers' contribution rate was lowered to 16% for workers over 50, while in 2003 the long-term target contribution rate of 40% was replaced by a flexible range 30%–36%.

Source: Frankfurt School of Finance & Management.

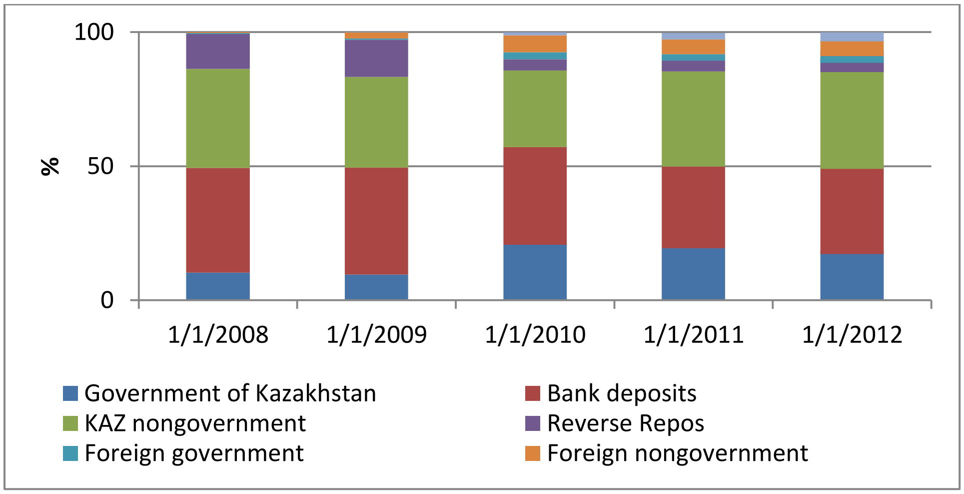
251. Reporting requirements for current accumulative pension funds are onerous. Reports showing all transactions executed on the day are submitted to the regulator on a daily basis. Daily reports are also submitted to the Department of Labour, with evidence of contributors' inflows and outflows. The regulator also requires weekly reports detailing the structure of each portfolio and monthly reports setting out financial statements and prudential information. Of particular concern to accumulative pension funds are the weekly reports—especially the mark-to-market valuations of portfolios—as these valuations are based on spurious data. Mark-to-market valuations are reported to the regulator and published and used by contributors as the basis for making investment decisions between fund managers. The regulations require accumulative pension funds to apply the KASE yield curve for mark-to-market purposes (Figure 5).

252. Insurance companies, like accumulative pension funds, are subject to investment guidelines based on prudential requirements. These guidelines could act as a disincentive to invest in corporate securities, for example, because investments in rated corporate securities are included in calculating prudential capital based on a sliding scale. Hence lower-rated securities require higher provisioning, while investments in securities defined by the regulator as "nonrated" must be excluded from calculations for prudential capital. [146]

253. However, based on recent data, this conservative approach does not appear to apply across the industry.[147] Insurance companies were holding close to 37% of assets in bonds of nongovernment Kazakhstan issuers as of October 2011, while around 32% of assets were invested in bank deposits (Figure 7). Investments in government securities only accounted for around 18% of assets.

Figure 7: Investment Portfolio Structure of Insurance (Reinsurance) Organizations

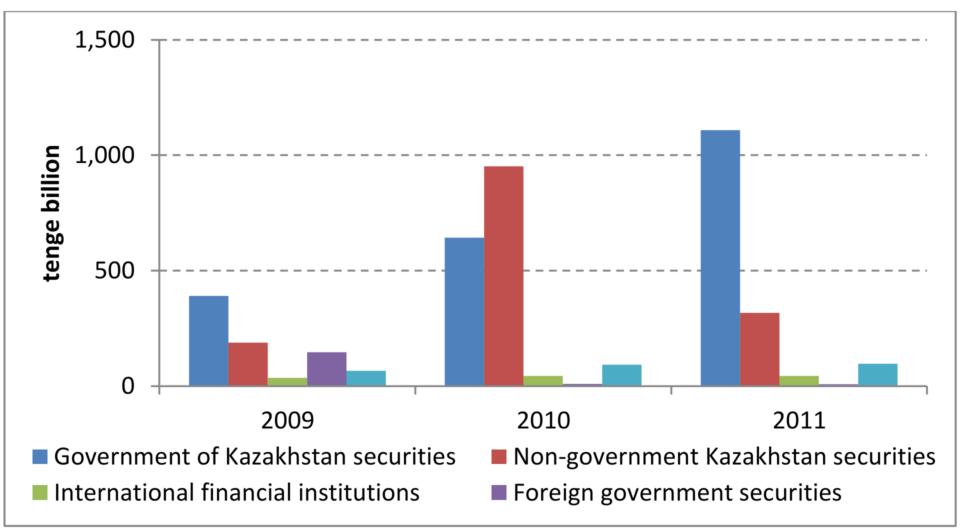
[146] Despite being rated by a domestic credit rating agency.
[147] National Bank of Kazakhstan (NBK). 2011. "Kazakhstan Financial Stability Report." December. NBK.



KAZ = Kazakhstan.
Source: National Bank of the Republic Kazakhstan. 2012. *Financial Stability Report of Kazakhstan 2011 and 2012*. Astana.

254. In developed markets, banks are active participants in securities markets and may hold relatively large portfolios of securities, mostly for trading purposes. However, in Kazakhstan, the banks' licenses forbid trading of corporate debt with customers. Thus, although banks can broker government bonds on behalf of clients, they are not permitted to act as brokers on corporate securities. As depicted in Figure 8, some 70% of banks' securities portfolios was invested in government securities in 2011, with around one-third of this invested in NBK Treasury notes (see Table 21). The inability of banks to broker corporate debt could go some way to explaining the relatively small share of such securities in their portfolios (around 20% in 2009 and 2011). However, in 2010, banks dramatically increased their holdings of Kazakhstan's nongovernment securities to around 55%.[148]

Figure 8: Banks' Securities Portfolios (as of period end)



Source: National Bank of Kazakhstan (NBK). 2011. "Kazakhstan Financial Stability Report." December. NBK.

[148] The rationale of this was not explored with banks during the mission due to the lack of supporting data at the time.

255. Mutual investment funds were established in Kazakhstan in 2005 and grew in popularity over 2006–2007 due to strong performance and high results. Funds' assets almost tripled in the first 2 years of operations, and by 2007, there were 86 mutual investment funds. Total assets under management were T48.60 billion ($329.49 million), driven mainly by rapid growth in Kazakhstan's economy and the phenomenal growth of the stock market. The growing securities market in 2006–2007 presented big opportunities for mutual funds, but the global financial crisis, which in the second half of 2008 nearly brought down the entire mutual investment fund industry, became a serious test for asset managers and exposed market vulnerability. As of the beginning of 2012, there were only 1,944 holders of unit investment funds, with total assets of unit investment funds and joint stock investment funds of T456.20 billion ($3.09 billion) and T28.80 billion ($0.20 billion) respectively.[149] There is still an overhang of real estate investments in the sector. Around 85% unit investment fund assets are invested in (non-joint stock company) legal entities' equity, while joint stock investment funds are heavily exposed to real estate.

3. Constraints to Securities Market Development

256. A number of measures have been identified that can further develop the securities markets in Kazakhstan. Stronger coordination in the direction of policy development for the securities market is needed (see Current Status below).

257. Bond conventions and practices need to be aligned with international standards, by adopting the GMRA, for example. In addition, further harmonization of bond market practices and conventions within the region could be advantageous and position Kazakhstan as a regional hub. This would facilitate the entry of global investors into the region's bond markets (see Current Status below).

258. A benchmark government borrowing program needs to be developed to facilitate the growth of the fixed income market in Kazakhstan and support market development (see Current Status). It has been suggested that, given the country's natural resources and the National Fund, the country should not be burdened with the cost of debt service resulting from a benchmark issuance program. However, the government's pledge to provide all retirees with inflation protection on Pillar II contributions may increase pressure on the government budget. Mindful of the long-run interests of economic development and social cohesion, the proceeds of natural resources may be most effective if invested in developing Kazakhstan's infrastructure—including human capital—with the development of the financial market, in particular the government securities market, providing bedrock support for economic growth.

259. Although the stock market is large relative to its regional peers, most trading is in spot foreign exchange and repos and, to a lesser extent, in products typically seen as the backbone of stock exchange trading. Additionally, the contribution of the equity market to turnover on KASE—at 0.54% in 2011—is small. This acts as a disincentive for institutional investors, whether domestic or foreign. Several factors contribute to this: (i) based on the law On Joint Stock Companies (2002) there are no public companies, and therefore less focus on equity capital as a source of funds; (ii) only a couple initial public offerings of state owned enterprises have taken place to date, although more are planned under the People's IPO (initial public offering);[150] (iii) some 73% of listed issuers and 65% of listed issues are in category 3, the least

[149] Committee for the Control and Supervision of the Financial Market and Financial Organizations of the National Bank of Kazakhstan. 2012.

[150] The Ministry of Economic Development and Trade, jointly with the Samruk-Kazyna, developed the People's IPO project, also known as the Program of Allocation of Shares of Subsidiaries and Associated Companies of Samruk-Kazyna in the Stock Market, and approved in September 2011. Developed in coordination with concerned government agencies and organizations and supported by independent consultants, its term is 2011–2015.

onerous category for disclosure; and (iv) the free float is small, in addition to which, there is no requirement for listings in category 3 to maintain an acceptable level of free float (see Current Status).

260. A broader investor base needs is needed. It is currently dominated by buy-and-hold investors, a situation compounded by disincentives to trading in the secondary market. Prudential guidelines for pension funds can be further developed to encourage investment in corporate securities (see Current Status).

4. Roadmap for the Development of the Securities Market

261. The proposed technical assistance is expected to strengthen the nonbank finance sector to underpin domestic savings and support real economic growth The desired outcome would be to achieve a deeper, more diversified nonbank finance sector and to expand the finance sector. The technical assistance would therefore have four outputs sequenced in four respective phases where the activities can take place simultaneously.[151] The phases include the development of (i) policy and consensus building, (ii) primary market for government securities, (iii) secondary market for government securities, and (iv) corporate bond market. The four outputs are to (i) review the role of government debt management in supporting the real economy, (ii) develop effective and appropriate securities market regulation, (iii) cultivate benchmark debt issuance program, and (iv) build capacity.

262. **Phases of Securities Market Development.** As noted, the development of securities markets can be conceptualized as generally occurring in four phases.[152] The phases include policy development with an emphasis on consensus and building effective primary and secondary markets for government securities, thereafter progressing to an efficient corporate bond market. As with any roadmap, there will be various points at which the route will branch and relevant authorities will need to make decisions as to which of the possible alternative paths to take. These design decisions should be based on an assessment of the benefits and drawbacks of each of the possible options and should be made in close consultation with the industry and other stakeholders. Some of the critical design decisions can be made early on and independent of other decisions, while others will need to be sequenced later in the process. It is crucial that measures should be carefully sequenced, not just to reflect the hierarchy and complementarily of markets and related institutional structures, but also to mitigate risks in parallel with reforms to expand the market.

263. The emphasis in the initial phase should be on policy development and consensus building. It is essential to achieve broad concurrence with the strategy to be implemented for development of the securities markets. While consensus was achieved in pension reform, other areas, such as the development of the government bond market could be further strengthened. The consultation process should not end at phase one; rather, it should be ongoing since the market will be continually evolving with the advent of new technologies, products, and services. It is critical that the government remain engaged and has active dialogue with market

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Samruk-Kazyna selected a number of companies whose shares began to be offered in stages over several years starting from 2012. Thus, the first on the market were displayed first-tier companies—KazTransOil, Kazakhstan Electricity Grid Operating Company; the second tier includes KazTransGas, Kazmortransflot and Samruk-Energo; the third tier is Kazakhstan Railways and Kaztemirtrans; and lastly, KazMunayGas and Kazatomprom.

[151] Asia-Pacific Economic Cooperation (APEC). 1999. *Compendium of Sound Practices: Guidelines to Facilitate the Development of Domestic Bond Markets in APEC Member Economies, September 1999.* Singapore: APEC. http://publications.apec.org/publication-detail.php?pub_id=698.

[152] This is consistent with the stages suggested in the Compendium of Sound Practices for the development of domestic bond markets.

intermediaries and the greater financial community in order to accurately anticipate the markets' needs and continually adjust.

264. Emphasis in the second phase is on development of an effective primary market for government securities. The focus therefore is on strengthening government cash management capacity, developing a benchmark yield curve, reliance on indirect monetary policy instruments, widening the range of targeted investors beyond the banking system, and accumulative pension funds and information dissemination. The Ministry of Finance is in the early stages of implementing a benchmark issuing strategy by tapping outstanding issues. While the approach to public debt management was not explored in the current assessment, it appears that this could be strengthened through greater coordination between the government's public debt management program and the NBK's monetary policy operations. While the Ministry of Finance promotes the timely availability of information about the planned issuing calendar, it seems there is insufficient information about the government's debt management strategy.[153] The Ministry of Finance has also adopted an auction method for government bonds. However, the auction process could be developed to more effectively enhance the efficiency of bond issuance. For investor certainty, the auction calendar should be adhered to, rather than announcing a long-dated government bond auction 2 days before the auction or cancelling an auction once bids have been submitted. When an additional auction is necessary, investors should be given adequate notice of the change, preferably at least 4 weeks.[154] The adoption of an efficient primary dealer mechanism would be a factor in increasing secondary market liquidity for government bonds, in the process contributing to development of a benchmark yield curve which would, in turn, support growth of other fixed income securities, including corporate bonds and derivatives. The repo market could also be strengthened by adopting standard documentation in the form of the Global Master Repo Agreement, with local market conventions detailed in an annex. Adoption of such standardized documentation reassures offshore investors.

Finally, the securities markets have been unable to capitalize on the benefits of pension reform. The level of assets under management has outstripped the availability of investible assets in the domestic market. It is therefore necessary to increase the stock of such assets in the local capital market. The People's IPO could provide fund managers additional equity securities and increase the free float on KASE. However, pension funds are primarily fixed income investors attracted to predictable future income streams. As noted, a benchmark government bond program would underpin growth in other fixed income securities, such as issues of corporate bonds and asset backed securities, as well as futures and other derivative instruments, to facilitate risk management. This would, in turn, increase the availability of investible assets for fund managers.

265. In the third phase, which often overlaps with the work performed in the second, the focus is on the development of a secondary market for government securities. Three aspects of a work program could be pursued to improve market liquidity:

(i) Enhance market infrastructure: this includes the legal and regulatory framework, the clearing and settlement and payment systems, the market for repurchase agreements, and bond borrowing and lending arrangements, as appropriate.

[153] Such information is crucial to building an effective primary government bond market given its importance to decision making among intermediaries and investors.
[154] In this regard, it is important to pursue regularity, standardization, and fungibility of bond issuance.

(ii) Conduct a comprehensive study to identify, then commence the mitigation of the adverse effects of legal, regulatory, accounting, and tax impediments to investment in and trading of bonds.

(iii) Enhance the information dissemination mechanism for bonds to facilitate trading and protect investor interests. The role of intermediaries, such as market makers and interdealer brokers, should be augmented to deepen the market and increase liquidity. Establishment of a bond or interest rate futures market would also merits consideration when the cash market has attained adequate maturity.

266. The legal and regulatory framework could better support market development. Prudential guidelines for accumulative pension funds and insurance companies are not appropriate for asset managers. The current risk based system considers the risks of particular investments and, as such, is similar to the approach used to regulate banks. It would be preferable for the system to focus on the risks of defined contribution liabilities, namely, achieving acceptable investment returns that could maintain the value (in real terms) of savings. Regulations for pension funds (and insurance companies) also create an impediment to demand for securities that are either unrated or are rated by a local credit rating agencies due to the higher (150%) risk weighting. As noted, the regulator allows pension funds and insurance companies to invest in bonds rated by the local agencies, but the bonds carry a much higher risk weighting for capital adequacy or liquidity purposes and must be rated higher than single –B.[155]

Problems were also noted with clearing and settlement of corporate bonds. It appears that the central bank is not active in managing overnight liquidity, with the result that there are regular liquidity spikes. At the same time, overnight repos are primarily transacted on KASE. Although the repo market is functioning, activity in the interbank market is lackluster. Establishing interdealer brokers could facilitate this process by allowing banks to transact through a broker, thereby introducing counterparty anonymity. Establishing a facility to support bond borrowing and lending could contribute to (i) repo activity, thereby enhancing money market liquidity and; (ii) liquidity in the secondary bond market.[156]

Activity in the OTC market could also be encouraged. The market is small and unorganized, with restrictions on securities that can be traded off-exchange (presently only government securities and unlisted securities). Standard trade processing has not been adopted (counter-parties can negotiate trade settlement up to T+3). Most importantly, there appears to be no mechanism for capturing trade data, such as prices and volumes for securities that are traded OTC. The provision of trade data is critical to building investor confidence in the OTC market as well as the wider fixed income market: it provides investors with actual prices to be used for market-to-market (MTM) calculations as well as supplying a pricing reference for new issues. As such, it will ultimately assist in the development of the corporate bond market

267. Finally—and again there is some overlap between the last two phases—the development of an efficient corporate bond market should be emphasized. Transparency and disclosure requirements, the appropriate use of credit rating agencies, tax, and other regulatory issues should be addressed during this stage. Issues around the regulatory treatment of bonds rated by international versus domestic credit rating agencies should be addressed. Related to the accounting regime, the audit methodology could be strengthened to increase confidence in financial statements, which in turn could contribute to corporate bond market growth. Encouraging the approval process of new corporate bond issues to operate on a full disclosure,

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[155] Pension funds must provision 150% if the issue is only rated by a local rating agency, compared with 100% for corporate bonds rated by an international credit rating agency.

[156] Securities lending would also provide fund managers an additional source of revenue

rather than merit basis, could help shorten approval, which now can take at least 1 month for regulatory approval, followed by at least 1 month for listing approval from KASE.

268. In preparing the roadmap the issue of appropriate sequencing in the four phases is fundamental, as discussed above and developed below.

Phase 1: Policy Development and Consensus Building

- (i) Develop broad consensus among all stakeholders relevant to stated policy aims and strategy for developing securities markets.

Phase 2: Effective Primary Market for Government Securities

- (i) Consider incentives for financing through the stock market.
    - (1) Review criteria for companies listing in category 3.
- (ii) Strengthen and enforce minority shareholder rights.
- (iii) Establish and enforce adequate corporate governance standards.
- (iv) Adopt prudential regulations to strengthen market surveillance and enforcement.
- (v) Implement action plan for money market development.
    - (1) Improve legal framework, including accounting and prudential regulations for repos, sell-buybacks, and securities lending.
    - (2) Adopt Global Master Repurchase Agreement with annex.
    - (3) NBK to actively manage market liquidity via repos and reverse repos.
    - (4) Permit automated facility for securities lending.
    - (5) Consider introduction of interdealer broker to ensure anonymity.
- (vi) Introduce benchmark government bond issuance program.
    - (1) Consolidate outstanding issuance in maturities longer than 3 years.
    - (2) Progressively build benchmark issuance and hence, yield curve.
- (vii) Review and amend prudential guidelines for institutional investors.
- (viii) Capacity building for financial institutions in risk management and credit analysis.
- (ix) Develop licensing examinations for securities market professionals.
- (x) Promote investor protection and education through awareness programs.

Phase 3: Effective Secondary Market for Government Securities

- (i) Establish a system for systemic risk management.
- (ii) Address weaknesses in market information dissemination, in particular related to the OTC market.
- (iii) Establish procedures for bond borrowing and lending.
- (iv) Encourage issuance of equity-related bonds, such as convertible bonds.
- (v) Initiate a full-disclosure-based framework for corporate bond issuance.
- (vi) Introduce infrastructure to support private placements.
- (vii) Identify a securities industry association as a potential forerunner to a self-regulatory organization.
- (viii) Develop and enforce trading practices for market intermediaries.
- (ix) Establish central registry for all securities.
- (x) Streamline clearing and settlement procedures to allow full delivery versus payment.

Phase 4: Efficient Corporate Bond Market

(i) Develop markets for government bond futures and options.
(ii) Adopt and enforce full-disclosure framework for corporate bond issuance.
(iii) Strengthen the legal framework to facilitate the realization of collateral and promulgate an asset securitization law that permits (bankruptcy remote) special purpose vehicles.
(iv) Recognize a self-regulatory organization within the industry.

269. As an adjunct to the roadmap, outputs and actions have been identified that will contribute to the development of specific aspects of the local securities market.

Table 24: Outputs and Activities for the Development of the Securities Market

Outputs	Activities
Review role of government debt management in supporting the real economy.	• Provide support to the Ministry of Finance in defining and prioritizing objectives regarding sovereign debt management policy and strategy for bond market development. • Develop a comprehensive strategy in consultation with the National Bank of Kazakhstan, the relevant regulatory agencies and market participants to address the various roles played by the government and relevant parties: as issuer, regulator, facilitator or, where appropriate, provider of market infrastructure. • Promote consistent strategy for (i) sovereign debt management and the bond market, (ii) fiscal and monetary policies, and (iii) finance sector development.
Develop effective, appropriate securities market regulation.	• Conduct a detailed review of existing regulations and prudential guidelines of nonbank financial institutions. • Identify elements of the regulations that create distortions and/or act as disincentives to market activity. • Revise regulations and prudential guidelines accordingly.
Cultivate benchmark debt issuance program.	• Build an accurate and reliable benchmark yield curve through the issuance of bonds at appropriately spaced benchmark maturities along the yield curve to build liquidity; ensure large volume issuance, consolidation of outstanding issues and/or suitable reopening of bond issues to maintain liquidity. • Introduce primary dealers and keep transaction costs low to enhance trading activities by maintaining a competitive dealer structure for trading activities and standardizing trading conventions and settlement processes. • Enhance transparency in the primary and secondary markets to promote market participation and, hence, market liquidity. Improve disclosure of market information to assist market participants in formulating their investment strategies. Promptly disclose trade information in the secondary market, paying due attention to ensuring anonymity of market participants. • Promote transparency in trading and price reporting to deter manipulation and unfair trading practices. • Develop derivatives markets and facilities such as futures markets, swaps markets, repo markets, and securities lending facilities, as appropriate, to facilitate different investors in constructing their investment portfolios and risk management strategies, hence increasing liquidity and trading activities.
Build capacity.	• Identify training needs. • Provide training and work-shops to develop skills of regulatory staff. • Promote financial literacy across the country.

Source: Frankfurt School of Finance & Management.

5. Options for the Securities Market

270. To understand the major constraints in developing the securities market in Kazakhstan, options to consider at both the regional level and country level include the following.

Technical assistance:

(i) build capacity through training programs; and
(ii) develop and promote financial literacy program.

Country Assistance Programs:

Conduct capacity building at the regulator to:

(i) facilitate a move to a full-disclosure approval process;
(ii) develop appropriate prudential guidelines for institutional investors; and
(iii) engage resident expert to work with Ministry of Finance officials for 2–3 years to develop a debt management strategy and benchmark issuance program.

III. GOVERNMENT'S SECTOR STRATEGY

A. Current Status

271. The Council on Financial Stability and Development of the Financial Market was established in June 2010 to facilitate interaction between state bodies and the development of proposals on matters of preserving financial stability and effective development of the finance sector. The council is chaired by NBK Governor Grigoriy Marchenko. Under the council, a number of working groups were formed and focused on the development of concrete measures for specific sectors, formalized in the end in a roadmap.

272. From the Strategic Development Plan of Kazakhstan-2020, developed in 2010, the Ministry of Finance, the NBK, and the FSC adapted the Concept of Post-Crisis Development of the Financial Sector and each institution's mid-term strategic plans. The key area in regulating the finance sector will be the continued transition to the principles of countercyclical regulation and supervision, accompanied with the package of measures to build up provisions and increase equity capital, reserves, and liquidity in the period of an economic boom so that to use the accumulated potential during a recession.[157]

273. The FSC plans to continue its effort to implement Basel-III-based international approaches to capital adequacy. In particular, effective from the year 2013, the regulations would be designed to:

(i) strengthen the capital base in banks through the introduction of common equity consisting of common shares and retained earnings;
(ii) discourage banks' investment activities by excluding double counting of bank capital;
(iii) restrict excessive growth in the loan portfolio by employing capital buffers; and
(iv) raise capital adequacy (bring the common equity requirement to 7%, Tier-1 capital requirement to 8.5%, and the own capital requirement to 10.5%).

[157] Committee for the control and supervision of financial market and financial organizations (FSC) of the National Bank. Concept of development of the financial sector of the Republic of Kazakhstan for 2007–2011. http://www.afn.kz/attachments/12/264/publish264-1633896258..pdf

274. The conception of the finance sector development in the post-crisis period implies that deposits taken by banks from individuals and legal entities should remain the major source of funding for the finance sector. The regulation of the securities market and accumulative pension system will be aimed at:

(i) further strengthening the financial sustainability of accumulative pension funds and professional participants in the securities market, including through further enhancing the risk-based supervision of securities market entities;
(ii) developing the home stock market through implementing measures that have been specified in the Implementation Plan for the Roadmap and enhancing the mechanisms for inducing investors' issuers to intensify their activities in the securities market for the protection of investors' rights and interests; and
(iii) developing collaboration with international organizations in the sphere of the regulation of the securities market.

275. In the insurance sector, the FSC plans the following additional measures:
(i) to strengthen state oversight of the compliance by the insured parties with the legislation of Kazakhstan concerning compulsory insurance;
(ii) to expand investment possibilities for life insurance organizations; and
(iii) to enhance the prudential regulation of insurance (reinsurance) organizations, including additional measures to increase Kazakhstan's content in the reinsurance business and cause a reduction in sham deals.

B. Development Goals

276. The Ministry of Finance Strategic Plan 2011–2015 identifies two strategic directions:

(i) The stability of public finances. A balanced republican budget, increasing the assets of the National fund in 2020 to no less than 30% of GDP and maintaining the size of government debt at an acceptable level.
(ii) Improving the effectiveness of regulation in the field of bankruptcy and the improvement of accounting and financial reporting, including in public institutions.[158]

277. The National Bank Strategic Plan 2011–2015 focuses on monetary policy and currency regulation: (i) design and conduct the state monetary policy, including stability of prices and fostering finance sector stability; (ii) implementation of effective currency regulation and currency control; and (iii) operation of payment systems.[159]

278. The FSC Strategic Development Plan 2011–2015 underlines five strategic directions to work on: (i) improving the efficiency of regulation and supervision of financial markets and financial institutions in accordance with international standards, through institutional strengthening and development; (ii) increased financial stability and competitiveness of the banking sector, further development of regulation in accordance with the global standards of supervision; (iii) the development of the insurance market and the improvement of insurance

[158] Ministry of Finance. *Strategic Plan of the Ministry of Finance of the Republic of Kazakhstan for 2011–2015 years*. http://www.minfin.gov.kz/irj/portal/anonymous?NavigationTarget=ROLES://portal_content/mf/kz.ecc.roles/kz.ecc.anonymous/kz.ecc.anonymous/kz.ecc.anonym_activities/activities/plans_and_reports_fldr.
[159] National Bank of the Republic of Kazakhstan. *National Bank Strategic Plan for 2011–2015 with adjustments*. http://www.nationalbank.kz/?docid=873

supervision based on international best practices; (iv) the development of the securities market; and (vi) the development of an accumulative pension system.[160]

279. KASE has also developed its own development strategy for 2011–2013, in line with the above mentioned programs: (i) an increase of exchange market capitalization and the liquidity level circulating in KASE securities and an extension of the KASE-provided range of services and traded financial instruments; and (ii) implementation of international standards in all KASE areas of activity to enhance its brand, raise share value, and obtain worldwide recognition for KASE.[161]

280. The roadmap for the development of accumulative pension system and the securities market of the Republic of Kazakhstan, approved in January 2011, outlines the tasks of the FSC, the NBK, and the Ministry of Finance (as well as, in part, some other ministries and institutes) for 2011–2012, including: (i) improving the regulation of a pension system, and (ii) developing the securities market.[162]

281. All these measures address the existing deficiencies of the pension system and securities market, including the low profitability of pension funds, the lack of good quality financial instruments, stimulation of investors and issuers for release on the local stock market, and the enhancement of prudential regulation.

282. As noted, the People's IPO project was approved by the government in September 2011 and developed by the Ministry of Economic Development and Trade jointly with the Samruk-Kazyna in coordination with concerned government agencies and organizations (see footnote 177).[163]

283. The program also contains proposals to improve legislation, in connection with the planned initial public offering. To avoid the concentration of shares in the hands of a limited group, the program includes the introduction of restrictions on the maximum number of shares to be acquired by individuals. As part of the program, a number of measures will take place to raise awareness about the program and the potential benefit from participation in the People's IPO. The network of branches of Kazpost will be used for maximum geographic coverage.

IV. ADB SECTOR EXPERIENCE AND PROGRAM

A. Summary of Experience

284. ADB has long been providing assistance to Kazakhstan's finance sector, in particular to the banking and pension subsectors and for small and medium enterprise development through its operations in the form of loans and guarantees. In 2006–2008, ADB provided $175 million of unsecured senior loans and $150 million in credit guarantees for deferred payment rights to the banking sector.

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[160] Committee for the control and supervision of financial market and financial organizations of the National Bank of Kazakhstan. http://www.nationalbank.kz/?docid=873

[161] Kazakhstan Stock Exchange. *KASE Development Strategy for 2011–2013*. http://www.kase.kz/ru/strategy

[162] Committee for the control and supervision of financial market and financial organizations of the National Bank. *Roadmap for the development of accumulative pension system and the securities market.* http://www.afn.kz/attachments/2/23/publish23-1218633317..doc

[163] Samruk-Kazyna. The Program of Allocation of Shares of Subsidiaries and Associated Companies of "Samruk-Kazyna" in the Stock Market. http://www.sk.kz/section/3420.

To support securities market development, ADB extended advisory support to strengthen Kazakhstan's Law on Securitization by developing securitization procedures for asset-backed securities and regulatory capital requirements for securitization transactions. ADB is implementing the Small and Medium Enterprise Investment Program with DAMU, and allocated $150 million to three local banks for their on-lending to small and medium enterprises. The associated technical assistance supports DAMU in the strengthening of its corporate governance, risk management, and internal processes. Also, under the technical assistance, a survey is being conducted to study constraints to small and medium enterprise development and deliver recommendations on small and medium enterprise programs. In addition, the regional technical assistance, Financial Sector Development in Central and West Asia, under which this desk study is prepared, is laying the ground work for future assistance.

285. ADB's assistance is in line with government plans and will continue to help create an enabling environment for finance sector development, thus supporting economic growth under social and environmentally sustainable headings. Financial sector development is part of ADB's Strategy 2020 agenda and supplements private sector development, another core area.

B. Harmonization of Activities of Other International Finance Institutions

286. ADB has closely coordinated with other donors to improve the finance sector in Kazakhstan. Sector projects include the World Bank's Joint Economic Research Program covering the area of resolving nonperforming loans in the banking sector, strengthening the insolvency framework and pension scheme; Risk Based Supervision and Consolidated Supervision assistance to the FSC by USAID; Supporting Microfinance Transformation Processes in Central Asia of International Finance Corporation; Securitization transactions and Credit lines for small and medium enterprises through Kazakhstan's banks of KfW. To further collaboration and eliminate duplication, the activities of donors will be closely coordinated.

287. In preparation for the technical assistance, an ADB mission took place from March-April 2011, in which the government indicated areas of focus for ADB's future activities. The NBK and FSC suggested that ADB could assist in a number of key areas: strengthening capacity in financial stability analysis, assistance in refining the inflation targeting methodology, strengthening capacity in IFRS and sharia compliant accounting standards and their implementation, support in improving risk management of banks, risk based supervision and consolidated supervision, securities market and pension sector's development. The individual topics include the 3 subsectors as discussed in Chapter 2 of this desk-study (banking sector, capital market development, including pension sector and insurance sector).

288. A roadmap for the development of the securities market and pension sector, developed by the NBK and FSC in 2011, will be discussed and form a basis for the technical assistance for these sectors. The banking sector's nonperforming loans issue is covered by the World Bank's technical assistance, therefore the mission will focus on implementation of international standards (Basel III), identification of legal and regulatory constraints for the development of the banking sector, development of financial products for renewable energy and energy efficiency. The banking sector is also critical for the development of the securities market since banks (and/or its subsidiaries) are the major players in the securities market.

DONOR ACTIVITIES IN KAZAKHSTAN

1. World Bank

Active projects

- Capacity Building for Public Sector Accounting Reform
- Strengthening the National Statistical System of Kazakhstan
- Alma Transmission Project
- Technical & Vocational Education Modernization
- Kazakhstan - Tax Administration Reform Project (Joint Economic Research Program [JERP])
- Kazakhstan Moinak Electricity Transmission Project
- South-west roads: Western Europe - Western China international transit corridor
- Technology commercialization project
- Health Sector Technology Transfer and Institutional Reform
- Customs Development Project
- Kazakhstan - Extractive Industries Transparency Initiative.
- Ust-Kamenogorsk Environmental Remediation Project
- Forest Protection and Reforestation Project
- Agricultural Competitiveness Project
- Advising in resolving NPLs in banking sector (JERP)
- Strengthening the insolvency framework and pension scheme (JERP)

Activities in the pipeline

- Second Irrigation and Drainage Improvement Project
- Syr Darya Control and Northern Aral Sea Project - Phase II

Loans to the Government of Kazakhstan
Since July 1992 the World Bank has allocated 35 loans worth over $5.2 billion to Kazakhstan.

- $33 million loan to modernize the country's vocational education.
- $78 million loan for the Kazakhstan Alma Electricity Transmission Project to improve the reliability and quality of electricity supply to consumers in the Almaty region.
- $1 billion in budget support to help the government implement its economic program in 2010–2011.
- $68 million in total loans for a dam project to save Aral Sea.
- $2,125.00 million to finance the Kazakhstan South-West Roads Project. The loan is being extended for a 25-year period, with a 5-year grace period.

Relevant projects to the banking and finance sector.

The World Bank is primarily involved in three areas in the finance sector.

- Re-privatization of banks, which includes resolving the issue of nonperforming loans.

- Strengthening the insolvency framework, which includes developing a quicker and more efficient resolution of insolvencies. The insolvency law is weak in addressing reorganization processes, liquidation processes, and the treatment of estate assets.
- Pension scheme. In 2010, technical assistance on pension reform option simulation toolkit was approved.

Recently approved finance sector related programs/projects include:

- Technical and vocation education modernization, approved 2010–2014.
- Tax administration reform project (JERP), approved 2010.
- Development program lending, approved May 2010 and closed January 2011.

2. International Finance Corporation

Kazakhstan has been a member of the International Finance Corporation (IFC) since 1993.

(i) Kazakhstan has received commitments of over $600 million of IFC's own funds and over $282 million in syndications.

(ii) IFC's investments in the country have been mainly in the financial, oil and gas, and general manufacturing sectors.

The IFC focuses on stabilization, diversification, and support of the banking sector, and the establishment of the best international banking practices, corporate governance, and regulatory environment.

Advisory Services Projects

The IFC is working on several regional initiatives:

- Corporate governance (co-funded by the beneficiary company with 50%) (throughout the region)—Improving Corporate Governance in Central Asia. To meet these objectives, the project is working in Kazakhstan, the Kyrgyz Republic, and Tajikistan on the following principle activities: working with joint-stock companies and banks to implement and improve corporate governance practices; advising on improvements to the legislation and regulatory environment regulating corporate governance issues; partnering with local educational and training institutions to help develop corporate governance programs targeted to the needs of the next generation of business leaders; conducting a public education campaign to raise awareness about corporate governance in Central Asia and its shareholder base.
- Micro finance transformation project (Kyrgyz Republic and Tajikistan)—Supporting Microfinance Transformation Processes in Central Asia. The goal of the project is to support microfinance institutions in Azerbaijan, Kazakhstan, the Kyrgyz Republic, and Tajikistan in their corporate transformation processes and to improve the regulatory framework for microfinance in the region. The project helps to develop a broader range of financial services and increase access to finance for micro entrepreneurs and the population across the region.
- Azerbaijan-Central Asia Financial Markets Infrastructure Advisory Services Project - Supporting the Development of Credit Bureaus—The project aims to strengthen financial markets infrastructure in Azerbaijan and Central Asia (Kyrgyz Republic, Tajikistan, and Uzbekistan) by developing effective credit

information sharing and introducing formal risk education and certification for financial institution employees. The project should help financial institutions make faster and accurate credit decisions, thereby increasing the availability and affordability of financial services for individual consumers, as well as for micro, small, and medium enterprises in the region.
- Tajikistan Agribusiness Finance and Business Environment Project - Improving Business Environment for Agribusiness in Tajikistan. The goal of the project is to contribute to the development of the agriculture sector in Tajikistan by reducing the regulatory burden on farmers and agribusiness entities and by increasing their access to finance through lease and equipment financing.
- Regional credit bureau (there is a private credit bureau in Kazakhstan with about 29% coverage).

Equity Investments

As IFC's largest client in Central Asia, Kazakhstan received commitments of over $1 billion of IFC funds and over $400 million in syndications through December 2009. IFC's investments in Kazakhstan have been mainly in the financial, general manufacturing, and services sectors.

- $115 million to Bank CenterCredit in 2008, banking (loans and diversified payment rights).
- $180 million to Jambyl Cement in 2008, construction materials, (loans).
- $95 million to Eurasia RED in 2009, real estate industry (loans).
- $75 million to ATFBank in 2009, banking (sub loan).
- $85 million to Bank CenterCredit in 2009, banking (sub loan).
- $2 million to Ust-Kamenogorsk Poultry Farm in 2010, poultry farming (loan).
- Kazpost in 2011, loan up to $25 million.
- KazMicroFinance in 2011, senior loan up to $8 million.
- Caspi Cement in 2011, equity and quasi–equity investment up to $45 million.
- Sartas Teniz Port in 2011, equity and quasi–equity investment up to $11 million.

Pipeline of projects

- Arnur Credit, senior loan up to $3 million.

3. International Monetary Fund

- The last Article IV consultations were in June 2011.
- No outstanding loans.

4. United States Agency for International Development (USAID)

General Areas of support

- Economic Growth: After the independence of Kazakhstan, USAID in the 1990s supported the restructuring of a number of institutions and pieces of legislation crucial to the country's transition to a market economy. These reforms included privatization and pension reform, as well as numerous other laws governing Kazakhstan's economy. Improving policies related to cross-border trade, small- and medium-size enterprises, and finance sector stability. Accounting training program based on international standards for financial reporting.

- The Kazakhstan Small Business Development Project 2006–2010 was aimed to improve the effectiveness of government's small business support programs and develop a national network of small business service providers to improve the knowledge and skills of small business managers and entrepreneurs on a sustainable basis.
- Investing in People: Quality Health Care: Assisted in the challenge of making the health system financially viable and able to provide quality health care.
- Governing Justly and Democratically: Supporting development of a robust network of nongovernmental organizations that provide services and advocacy. Support to media outlets and improving transparency and public trust in the court system.

4. Relevant USAID projects to the economy as well as banking and finance sector

Risk based supervision and consolidated supervision:

- USAID is providing assistance to the FSC (through Deloitte) on risk based supervision and consolidated supervision. USAID has an advisor that covers the region.

Economic growth projects:

- Co-funded by the government (one-third USAID and two-thirds government)
- Business connections
  (i) Aim to increase small and medium enterprise in country training, this includes how to develop business plans, tours to US and Germany for example, to attend trade shows; and
  (ii) DAMU is the implementing agency. This means that companies need to get the funding from DAMU.
- Global development alliances
  (i) Support vocational training. Kazakhstan has substantial funds for vocational training and there is huge demand.
  (ii) Women's economic empowerment conference is planned for this summer. US Sec of State Clinton will attend.

5. United Nations Development Programme (UNDP)

The 2005–2009 country program supported national priorities in poverty reduction and monitoring, governance and participatory development, and environmental management and human security.

Currently the work of UNDP in Kazakhstan is regulated by the Country Programme Document and the Country Programme Action Plan for the period 2010–2015, which is in line with the national priorities and in support of the long-term strategy for the development of the country (Kazakhstan-2030). The program is focused on three areas:

(i) Economic and social well-being for all, with particular attention to vulnerable groups;
(ii) Environmental sustainability, focused on the sustainable management of natural resources; mitigation and adaptation to climate change; and preparedness for natural and man-made disasters; and

(iii) Effective governance, focused on promoting and protecting human rights and strengthening democratic institutions.

6. European Bank for Reconstruction and Development (EBRD)

EBRD is helping Kazakhstan diversify its economy, develop its finance sector, increase the efficiency and output of its power and energy industry, and improve its infrastructure. The Bank's commitment to Kazakhstan is reflected in the decision to hold EBRD's Annual Meeting in the capital, Astana, in May 2011.

The total portfolio amounts to 145 projects totaling €2.1 billion by gross disbursement volume and to €1.8 billion by outstanding volume. The share of the portfolio in the private sector is 58%; €668.0 million were invested in Kazakhstan in 2010 (as of March 2011).

Sector breakdown of current projects is as follows: corporate 14% (agribusiness, manufacturing and services, property, tourism, and telecommunications); energy 23% (natural resources and the power sector); financial institutions 25% (includes investments in micro, small, and medium enterprises via financial intermediaries); infrastructure 37% (municipal environmental infrastructure and transport).

- Equity investments in the finance sector (minority stakes in BTA Bank, KazKommerzBank, KazInvestBank).
- Loans and syndicated loans to banks (BankCenterCredit, KaspiBank).
- Direct financing to private sector (energy, infrastructure, agriculture, retail, transport).
- Local currency financing program.
- Trade facilitation program (Trade Finance) (VTB Bank).
- Business advisory services.
- $180 million syndicated loan to the Government of Kazakhstan for and infrastructure project, together with ADB, the Islamic Development Bank, International Bank for Reconstruction and Development, and Japan International Cooperation Agency (JICA).
- At the EBRD 2011 annual meeting it was announced to maintain EBRD`s annual investments to Kazakhstan at the level of $0.7 billion–$1 billion.

Focus areas for 2010–2013

- Liberalization and privatization. The government has extended its influence across the economy, at the firm and industry level, particularly with large employers in the mining, metal and construction sectors.
- Business environment and competition. But further improvements are recommended in tackling corruption issues.
- Infrastructure—Power and energy. A large segment of the Turkmenistan-People's Republic of China (PRC) gas pipeline was completed, leaving the connection from western Kazakhstan to the PRC to be built.
- Infrastructure—Transport. Kazakhstan started to make major investments to upgrade its road and rail infrastructure, including the rehabilitation of the road corridor between the western PRC and Western Europe.
- Financial sector. In response to the crisis in the banking sector, the government ensured substantial deposits for several banks and the central bank provided liquidity. Further measures are necessary to address portfolio quality.

7. Islamic Development Bank

- $414 million syndicated loan to Government of Kazakhstan for infrastructure projects together with ADB, JICA, International Bank for Reconstruction and Development, and EBRD.
- Net approved operations 1976–June 2010 are $576 million (43 operations).
- Project and trade financing.
- Technical assistance (agriculture, health, education, energy, transport, and so on).
- Support for the development of Islamic banking.

8. Japan International Cooperation Agency

- $100 million syndicated loan to the Government of Kazakhstan for infrastructure projects together with ADB, the Islamic Development Bank, International Bank for Reconstruction and Development, and EBRD.
- As of January 2012, JICA had provided about $1.5 billion in assistance to Kazakhstan, taking into account both technical assistance, such as the creation of the Japan Center and the master plan for Astana, and loan assistance, such as the construction of the Irtysh River Bridge, Astana International Airport, and water supply and sewer works in Astana.
- Japan has provided training to more than 1,000 people from Kazakhstan in Japan, who are now using the technology and knowledge they learned to help improve Kazakhstan.
- Support in energy efficiency, development of the uranium mining industry (training, visits to Japanese corporations, and so on).
- Kazakhstan-Japan Center for Human Development Project 2005–2010 (business and language courses).
- Building Economic Relations through Joint Government and Private-Sector Cooperation.

9. KfW

German Financial Cooperation with Kazakhstan began in 1993. More than €266 million was committed up to February 2009. In recent years activities have focused:

- Sustainable economic development

  (i) Securitization Transactions
  KfW is promoting the acquisition of securities under a securitization transaction to prevent a possible gap in the supply of issued paper. KfW also refinances 50% of a loan guarantee for the securitization of diversified payment rights issued by the ADB. This promotes the utilization of securitization as a form of financing. By supporting these measures, KfW is instrumental in improving access to investment capital for small and medium enterprises.

  (ii) Credit Lines for small and medium enterprises
  By refinancing credit lines KfW, in collaboration with the Deutsche Investitions- und Entwicklungs Gesellschaft (German Investment and Development Company) (DEG), promotes investment loan schemes for small and medium enterprises through private banks in Kazakhstan. These projects also improve access to mortgage loans.

- Health Care
  - (i) tuberculosis control
- Water Supply
  - (i) drinking water supply Aral Sea.
- Energy Sector
  - (i) promotion of renewable energies.

10. GTZ (Deutsche Gesellschaft für Zusammenarbeit)

Since 2000, bilateral cooperation has focused on supporting economic reforms and developing a market economy. GTZ activities currently focus on four key areas:

(i) Sustainable Economic Development
Promotes economic performance and innovation among small and medium enterprises through comprehensive promotional inputs and innovative policies. The objective of this priority area is to ensure sustainable economic growth:
(1) Support of regional economic cooperation in Central Asia (Creating a best practice framework for business development, Support for regional economic cooperation, Support for the management of the German-Kazakh Association of Entrepreneurs (DKAU), Support of Tourism); and
(2) Enhancing Economic and Environmental Welfare in the Aral Sea Region.

(ii) Promotion of Vocational Training
Seeks to further develop an internationally competitive vocational training system that is oriented to the needs of the economy:
(1) Reform of Educational Systems in Central Asia.

(iii) Environment and Climate
Promotes environmental protection and the sustainable use of natural resources:
(1) Programme Professional Education and Training in Central Asia;
(2) Sustainable use of natural resources in Central Asia; and
(3) Sustainable pasture management in Kazakhstan.

(iv) Good Governance
Promotes legal, judicial and administrative reforms in Kazakhstan:
(1) Support of Legal and Judicial Reform in Central Asian Countries.

EXAMPLES OF PROPOSED TERMS OF REFERENCE

A. Banking Sector

1. The three technical assistance proposals outlined below apply primarily to government agencies and their staff. There may be scope, however, to include key staff of financial institutions to participate in the development of legislation, procedures, workshops, and training.

1. Improved Disclosure of Information (18 person months)

2. The Law on Risk Minimization will be applied to banks and their affiliated companies through the NBK Department of Surveillance and Control Methodology. The law will improve the supervision of bank conglomerates, introduce greater transparency in the activities and sources of capital of financial institutions, improve the corporate governance in financial institutions and joint stock companies, ensure more timely and accurate disclosure of information, improve legal mechanisms for restructuring of banks within bank conglomerates, update procedures for restructuring of liabilities, raise bank supervision and regulation to international standards, and establish an effective system for the protection of investor rights to raise investor confidence in the securities market and further develop accumulative pension funds and investment fund operations. The scope of work for this Department is vast and challenging. Support in establishing and piloting methodologies and procedures and the evaluation of these could be useful. The technical assistance would:

(i) carry out an assessment of the extent of affiliation among firms, an outline of concerns that need to be addressed, and establish a time bound plan of actions to be taken;

(ii) assist and advise on improved procedures for the accounting of intercompany transactions to obtain (a) a proper assessment of assets and liabilities within each of the affiliates, and (b) a better assessment of risk within each affiliate and for the consolidated group as a whole;

(iii) assist in the development of procedures to be followed in the evaluation of the governance and internal controls, including management of risk, within affiliates and the consolidated group;

(iv) provide training to NBK staff in the evaluation of governance and internal controls within the supervised firms and deciding on actions to be taken for their improvement;

(v) assist the NBK in the development and use of computerized models to assess the effect of identifiable risks on firms and their affiliates. These models would be used its stress testing and would also be available to firms and their affiliates;

(vi) assist the NBK in compiling operating manuals;

(vii) conduct seminars, workshops and training courses for NBK staff and staff of supervised institutions that would cover risk identification and management, governance and internal controls, and improved accounting systems especially for conglomerates; and

(viii) assist in improving the structure and content of training course materials.

2. Improved Business Environment (12 person months)

3. Many defunct businesses have been stripped of assets making a claim against them by creditors almost worthless. There are, furthermore many borrowers who face insurmountable debt that will either result in the closure of their business or, at the minimum, severely constrain or prevent business growth. Large businesses are receiving professional assistance in debt workouts and restructuring. Small businesses are not. The *Law on Bankruptcy* is being amended to facilitate the liquidation or rehabilitation of businesses and households. Details of the amendments are unclear. There may be scope for a detailed review of the amendments and providing assistance in drafting related regulations and streamlined procedures to be followed. The technical assistance would work closely with the Justice Department, Ministry of Economic Development, and DAMU and would:

(i) review the Bankruptcy Law and its amendments, and hold discussions with government and financial institutions on ways to facilitate debt resolution processes envisaged under the law;

(ii) advise the government on legislative amendments that could improve the process of debt resolution and assist in developing appropriate regulations, instructions and procedures that would be followed by debtors and their creditors;

(iii) assist in the development of training materials and workshops for debt resolution that would be provided to Government agencies and financial institutions;

(iv) provide advice and training to DAMU on debt analysis and restructuring of small and medium enterprises; and

(v) assist DAMU in the development of advisory materials that could be used by DAMU in the assessment of excessive debt within small and medium enterprises and recommendations that DAMU could make for the rehabilitation of such small and medium enterprises.

3. Improved Outreach of Microfinance Services (12 person months, intermittent)

4. Firstly, the outreach of financial services in rural areas is much less than for urban areas. The challenge is how to provide a broad range of financial services in a cost-effective manner to rural areas where the volume and size of financial transactions tend to be small and therefore relatively expensive to users and suppliers of services. The market size is 1.6 million rural households engaged in farming, microenterprise and household activities. The range of services includes lending, savings, cash withdrawals and payments, money transfers including social benefits and state and local taxes, and insurance products. Secondly, the rapid growth in e-banking is changing financial service methodology with the result that previous methods of service delivery have become outmoded or require substantive change to remain cost-effective. This report has identified microfinance service suppliers such as banks, microfinance institutions, credit partnerships and mobile network operators. More information is required to assess the most efficacious way of providing different types of services and linkages among services to avoid the support of inefficient and ultimately obsolete service suppliers. The technical assistance would:

(i) assist the NBK, Ministry of Labor and the Ministry of Economic Development to develop a roadmap that would provide a comprehensive and attractive range of financial services to rural and urban households, microenterprises and farmers;

(ii) work with Government agencies and financial service suppliers in the assessment of microfinance consumer needs and identify areas of support to encourage outreach and efficiency of services. This could entail the implementation of a sample survey and its analysis;

(iii) assist the NBK to develop appropriate systems of monitoring the supply and use of microfinance services through banks, insurance firms, microfinance institutions and CPs including the content, frequency and mode of reporting;

(iv) assist the NBK to rationalize a selection process of microfinance institutions and CPs that would be subject to a cost-effective system of on-site and off-site supervision and assist the NBK in developing the required supervisory procedures through training, and the development of operational manuals and reporting standards;

(v) assist the NBK in drafting regulations as required for the licensing, monitoring and supervision of microfinance institutions and CPs;

(vi) review the financial literacy materials prepared by the Regional Finance Center Almaty and recommend ways to use and adapt these materials to achieve greater outreach among businesses and households; and

(vii) provide a study tour for key government representatives to countries that have implemented an advanced level of microfinance services.

B. Securities Market

1. Develop government debt management strategy and benchmark issuance program (24–36 person months)

2. It is essential for the government to earn the confidence of financial market participants in order to fund cost-efficiently and in a timely manner. This requires the presence of a credible government bond issuing strategy, anchored in a strong commitment to market financing coupled with a well-structured debt management framework. The issuance strategy should be consistent with the macroeconomic framework and widely circulated, setting measurable objectives in order to establish clear accountability. Within the parameters of the strategy, issuance for the period ahead should be discussed with market participants in order to reflect the specific needs of finance sector development. Ideally, there should be only one entity charged with responsibility for public debt management.

3. Public debt management should include finance sector development as one objective, both because this potentially lowers the cost and risk of debt management but also

because of the wider economic benefits.[164] In particular it will ensure that the funding strategy is consistent with building a government yield curve and sufficiently liquid government benchmark securities. In line with this, issuance should be concentrated in a relatively small number of standard maturities in order to develop liquidity in these issues, a move that will result in lower issuing costs over time. Development of benchmark issues will permit pricing of other financial instruments as well as facilitate secondary market trading. At the same time it is important to avoid fragmentation of the government bond market as a result of several public entities issuing 'government' securities i.e. there should only be one issuer of government bonds. In a similar vein, it is important that the government focuses on issuing a standard, marketable security and avoids issuing a variety of instruments that could lead to fragmentation of the government bond market.

4. As of 1 January 2012 there were 199 issues of government bonds outstanding in maturities out to 2031, for a total volume of T2.074 trillion ($14.09 billion). Issues range from T1.47 billion–T25 billion ($9.9 million–$169 million) with an average issue size of T10.42 billion ($70.6 million). The technical assistance would work across the Ministry of Finance and would:

   (i) Review the current approach to debt management and in discussions with the Ministry of Finance, the NBK the Ministry of Economy, devise a debt management strategy that is consistent with Kazakhstan's broader economic goals, including finance sector development as one of the key objectives;

   (ii) Advise government on legislative amendments that may be required to strengthen the process of public debt management e.g. establishing a debt management office;

   (iii) Work with officials in the debt management office to develop a strategy for benchmark bond issuance, concentrating issues in a relatively small number of standard maturities (this should include consolidation and/or reopening of outstanding issues with maturities longer than 3-years as well as new larger issues that can be tapped in the future to increase the volume outstanding);

   (iv) Support the debt management office in implementing this strategy—including communication with market participants—ensuring full co-ordination of all the relevant department at the Ministry of Finance as well as with the NBK; and

   (v) Provide capacity building where necessary to facilitate a broad understanding of the role and process of benchmark bond issuance.

[164] The main objective of public debt management, as emphasised by the IMF and World Bank, is to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk. But internationally many debt managers also set the development of efficient domestic financial markets as a subsidiary objective.

PROBLEM TREE

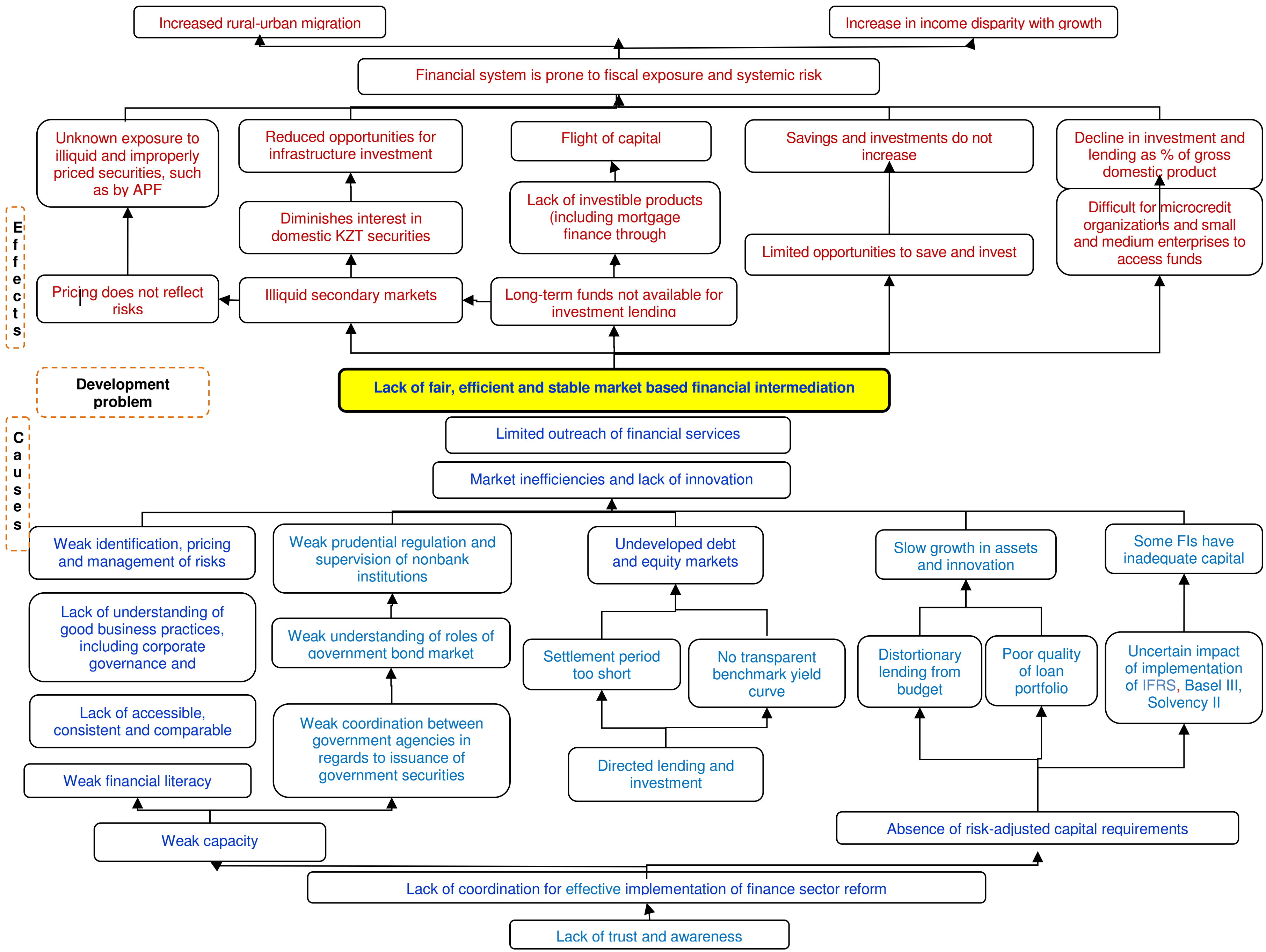

Table A4.1: Classification of Aggregate Loan Portfolios 2007–2011

Classification	End year	2007 Loan classification	2007 Loss provisions	2008 Loan classification	2008 Loss provisions	2009 Loan classification	2009 Loss provisions	2010 Loan classification	2010 Loss provisions	2011 Loan classification	2011 Loss provisions	Change Loan class 2007–2011
Total Loans outstanding	tenge million	8,868,306	520,192	9,244,543	1,025,581	9,638,851	3,630,991	9,066,022	2,802,166	10,442,888	3,336,037	1,574,582
Standard	"	3,534,006	120	3,977,302	261	2,449,227	272	2,389,866	184	2,690,621	232	-843,385
Doubtful	"	5,202,717	388,688	4,865,034	627,334	4,241,868	702,775	4,862,127	1,000,179	5,479,512	1,153,517	276,795
category 1	"	3,937,568	175,447	2,232,596	97,853	1,678,789	69,617	1,598,947	65,922	1,600,523	62,815	-2,337,045
category 2	"	575,454	41,658	595,821	50,316	376,271	30,357	573,714	47,863	687,730	57,704	112,276
category 3	"	529,625	105,523	1,577,427	304,111	1,266,348	248,479	954,443	189,191	1,286,674	236,028	757,049
category 4	"	55,261	13,638	205,980	50,274	225,516	55,313	489,423	120,678	427,169	104,027	371,908
category 5	"	104,809	52,423	253,210	124,780	694,944	299,009	1,245,600	576,525	1,477,417	692,944	1,372,608
Loss	"	131,583	131,383	402,207	397,986	2,947,757	2,927,945	1,814,029	1,801,804	2,272,755	2,182,287	2,141,172
Accumulated interest income	"	305,820		529,767		878,892		1,056,173		1,152,555		750,353
												3,513,780
Share of total portfolio:			6%		11%		38%		31%		32%	
Standard	%	40%		43%		25%		26%		26%		-54%
Doubtful	"	59%		53%		44%		54%		52%		18%
category 1	"	44%		24%		17%		18%		15%		-148%
category 2	"	6%		6%		4%		6%		7%		7%
category 3	"	6%		17%		13%		11%		12%		48%
category 4	"	1%		2%		2%		5%		4%		24%
category 5	"	1%		3%		7%		14%		14%		87%
Loss	"	1%		4%		31%		20%		22%		136%
Accumulated interest income	"	3%		6%		9%		12%		11%		48%

Source: Agency on Regulation and Supervision of the Financial Market and the Financial Organizations of the Republic of Kazakhstan.

Table A4.2: Tier-Two Banks Loan Classification: 1 January 2012 (tenge million)

	Bank Names	Total Loans outstanding	Standard Loans Amount	%	Doubtful Total	Doubtful Category 1	Doubtful Category 2	Doubtful Category 3	Doubtful Category 4	Doubtful Category 5	Bad Loans Amount	%	Non-Performing Loans Amount	%	Accumulated Interest Amount	%	Net worth	NPL/NW multiple
1	Kazkommertsbank	2.267.581	155.385	7	1.812.832	198.878	60.885	654.231	311.001	587.838	299.364	13	887.202	39,1	357.562	16	434.822	2,0
2	BTA Bank	2.090.364	121.536	6	956.685	233.789	150.699	41.372	16.841	513.984	1.012.143	48	1.526.127	73,0	316.743	15	-240.787	-6,3
3	Alliance Bank	535.070	99.368	19	233.751	112.145	38.454	5.673	14.559	62.920	201.952	38	264.873	49,5	64.298	12	8.728	30,3
4	Halyk Bank	1.371.567	324.240	24	841.317	278.814	168.483	277.974	9.501	106.545	206.010	15	312.555	22,8	114.931	8	289.769	1,1
5	ATF Bank	863.326	300.030	35	353.122	167.463	41.989	75.546	39.888	28.235	210.175	24	238.410	27,6	70.299	8	62.986	3,8
6	Bank CenterCredit	805.617	314.907	39	419.208	234.422	27.987	94.992	11.650	50.157	71.502	9	121.659	15,1	63.624	8	83.644	1,5
7	Temirbank	220.374	40.984	19	75.733	47.816	146	9.216	194	18.362	103.658	47	122.020	55,4	27.753	13	67.306	1,8
8	Nurbank	222.265	66.766	30	83.676	16.124	4.340	25.605	7.862	29.745	71.822	32	101.568	45,7	47.555	21	70.731	1,4
9	Kaspi Bank	361.418	90.936	25	247.005	29.092	156.696	16.027	7.369	37.821	23.477	6	61.298	17,0	27.940	8	46.960	1,3
10	Eurasian Bank	269.965	152.832	57	98.265	65.947	16.448	4.164	1.405	10.301	18.869	7	29.170	10,8	10.354	4	32.398	0,9
11	Tsesnabank	332.649	272.815	82	53.750	38.925	1.062	7.202	2.956	3.605	6.084	2	9.689	2,9	18.460	6	34.626	0,3
12	RBS (Kazakhstan)	17.419	13.987	80	1.352	51	0	11	0	1.290	2.080	12	3.370	19,3	154	1	19.665	0,2
13	Citibank Kazakhstan	86.751	66.409	77	18.689	883	0	16.170	0	1.635	1.653	2	3.288	3,8	253	0	24.018	0,1
14	HSBC Bank Kazakhstan	91.236	78.258	86	7.724	6.828	12	0	0	884	5.255	6	6.139	6,7	1.038	1	19.392	0,3
15	Eximbank Kazakhstan	66.211	29.620	45	33.055	6.361	3.724	13.808	0	9.163	3.536	5	12.698	19,2	13.623	21	13.588	0,9
16	Kazinvestbank	60.047	41.067	68	13.001	0	1.122	8.346	2	3.531	5.980	10	9.510	15,8	6.636	11	8.448	1,1
17	Sberbank	359.332	256.407	71	83.963	54.201	84	21.812	18	7.849	18.962	5	26.810	7,5	3.934	1	49.892	0,5
18	Alfa-Bank	51.569	36.254	70	13.619	4.101	0	9.041	405	72	1.696	3	1.768	3,4	59	0	12.878	0,1
19	Delta Bank	69.839	36.171	52	33.144	14.834	14.013	1.330	2.470	497	523	1	1.020	1,5	996	1	16.586	0,1
20	Bank Pozitif	9.131	6.191	68	1.626	1.379	6	50	2	188	1.314	14	1.502	16,5	899	10	11.051	0,1
21	PNB - Kazakhstan	1.151	802	70	273	268	0	0	4	0	77	7	77	6,7	87	8	10.158	0,0
22	House construction saving bank of Kazakhstan	90.684	17.575	19	73.027	71.844	15	20	0	1.147	82	0	1.229	1,4	1.283	1	89.333	0,0
23	AsiaCredit Bank	17.883	16.201	91	1.065	837	43	8	82	95	617	3	712	4,0	461	3	11.560	0,1
24	KZI Bank	4.333	2.790	64	739	123	186	318	41	72	804	19	876	20,2	43	1	11.583	0,1
25	Home Credit Bank	33.185	30.829	93	1.346	0	912	0	424	9	1.011	3	1.020	3,1	690	2	12.615	0,1
26	Senim-Bank	2.607	2.160	83	442	360	0	0	0	82	5	0	86	3,3	269	10	2.410	0,0
27	Zaman-Bank	4.453	3.627	81	528	157	0	109	86	176	298	7	474	10,6	33	1	4.187	0,1
28	RBK	20.611	18.012	87	2.554	1.038	0	1.349	167	0	46	0	46	0,2	393	2	5.475	0,0
29	Bank of China Kazakhstan	4.358	4.313	99	0	0	0	0	0	0	45	1	45	1,0	124	3	13.109	0,0
30	TAIB Kazak Bank	1.100	867	79	87	0	0	0	0	87	146	13	233	21,2	36	3	3.664	0,1
31	National Bank of Pakistan in Kazakhstan	2.645	2.602	98	3	0	0	3	0	0	39	1	39	1,5	24	1	4.240	0,0
32	ICBC Almaty	3.265	3.265	100	0	0	0	0	0	0	0	0	0	0,0	102	3	10.954	0,0
33	Metrocombank	12.995	9.927	76	834	622	0	134	17	61	2.233	17	2.294	17,7	389	3	8.655	0,3
34	Astana-Finance Bank	25.156	14.006	56	9.900	7.308	405	1.523	208	456	1.250	5	1.705	6,8	731	3	5.424	0,3
35	Shinhan Bank Kazakhstan	3.901	3.901	100	0	0	0	0	0	0	0	0	0	0,0	403	10	10.413	0,0
36	Bank VTB (Kazakhstan)	48.105	43.243	90	4.830	3.859	0	372	0	599	32	0	631	1,3	277	1	17.624	0,0
37	Bank Kassa Nova	10.601	8.216	78	2.367	2.053	18	268	17	10	18	0	28	0,3	86	1	7.144	0,0
38	Al-Hilal" Islamic Bank	4.124	4.124	100	0	0	0	0	0	0	0	0	0	0,0	13	0	10.226	0,0
39	JSC "redit Altyn Bank"																	
40	JSC "International Bank Almaty"																	
41	JSC "JB "LARIBA-BANK"																	
42	JSC "Express bank"																	
43	JSC "Demir Kazakhstan Bank"																	
44	JSC "Masterbank"																	
45	SJSB ABN AMRO Bank Kazakhstan JSC																	
	Totals	10.442.888	2.690.621	26	5.479.512	1.600.523	687.730	1.286.674	427.169	1.477.417	2.272.755	22	3.750.172	35,9	1.152.555	11	1.305.476	2,9
	Percentage of totals		26		52	15	7	12	4	14	22							

Source: FSA reports.
Note: Non-performing loans comprise bad loans plus category 5 doubtful loans.
JSC – Joint Stock Company
NPL – Non Performing Loans
NW – Net worth

Table A4.3: Performance of 10 Largest Banks Compared to the Remainder

Name of Bank	2010					2011						Return on	
	Total assets	Gross loans	Loss provisions	Net loans	Net worth	Total assets	Gross loans	Loss provisions	Net loans	Net worth	Net income	Assets (%)	Equity (%)
Kazkommertsbank	2,430	2,344	724.1	1,620	278	2,485	2,268	788	1,479	435	1	0.05	0.32
BTA Bank	1,994	1,645	921.8	723	181	1,617	2,090	1,303	787	-241	-23	-1.30	-79.09
Halyk Bank	2,024	1,224	285.7	938	268	2,222	1,372	325	1,046	290	36	1.72	13.07
ATF Bank	983	849	128.2	721	64	984	863	172	691	63	-37	-3.77	-58.36
Bank CenterCredit	1,211	720	109.6	610	77	1,063	806	129	677	84	3	0.28	3.96
Alliance Bank	490	546	318.9	227	34	530	535	242	293	9	n.a.	0.00	0.00
Kaspi Bank	353	289	40.7	248	36	422	361	59	302	47	12	3.10	29.04
Sberbank	283	177	11.8	165	40	491	359	19	340	50	8	1.96	16.85
Tsesnabank	227	149	10.2	139	24	438	333	12	321	35	4	1.23	14.01
Subtotal	9,994	7,943	2,551	5,392	1,002	10,252	8,987	3,051	5,936	771	4	0.04	0.44
Market share 10 largest banks	83%	88%	91%	86%	76%	80%	86%	91%	84%	59%	15%		
Eurasian Bank	359	228	23.5	205	26	370	270	27	243.0	32	7	1.82	22.85
Nurbank	261	201	84.6	116	44	267	222.3	94	128.3	71	-1	-0.41	-1.88
Temirbank	199	212	106.8	105	22	257	220.4	115.9	104.5	67	4	1.68	8.59
HSBC Bank Kazakhstan	243	88	5.2	83	15	165	91.2	5.8	85.4	19	4	1.88	22.45
House construction saving bank of Kazakhstan	101	68	2.3	66	25	213	90.7	1.6	89.1	89	-1	-0.36	-0.99
Citibank Kazakhstan7	221	38	0.6	37	22	346	86.8	1.5	85.3	24	3	1.21	15.01
Delta Bank	52	41	0.8	40	12	90	69.8	3.8	66.0	17	1	0.79	3.98
Eximbank Kazakhstan	84	67	8.3	59	13	86	66.2	11.4	54.8	14	0	0.27	1.72
Kazinvestbank	64	50	7.1	43	10	78	60	9.5	50.5	8	0	0.09	0.67
Alfa-Bank	94	31	3.2	28	10	106	51.6	3.8	47.8	13	1	1.09	9.43
Bank VTB (Kazakhstan)	22	10	0	10	8	62	48.1	0.5	47.6	18	-2	-4.35	-14.07
Home Credit Bank	19	14	0.8	13	7	45	33.2	1.3	31.9	13	6	18.74	62.09
Astana-Finance Bank	17	13	2	11	5	50	25.2	2.2	23.0	5	0	0.30	1.83
KazInComBank	6	3	0.1	3	4	39	20.6	0.2	20.4	5	0	0.13	0.62
AsiaCredit Bank	14	5	0.4	5	6	27	17.9	0.7	17.2	12	0	-1.93	-4.66
RBS (Kazakhstan)	120	14	0.7	13	19	135	17.4	0.7	16.7	20	0	-0.28	-1.83
Metrocombank	19	8	1.5	7	7	35	13	2.3	10.7	9	-1	-3.75	-13.34
Bank Kassa Nova	8	5	0.1	5	6	13	10.6	0.1	10.5	7	0	0.41	0.68
Bank Pozitif	15	3	1.5	2	5	18	9.1	1.5	7.6	11	0	-0.71	-1.43
Zaman-Bank	5	4	0.4	4	3	5	4.5	0.4	4.1	4	0	1.26	1.54
Bank of China Kazakhstan	55	3	0	3	12	59	4.4	0.1	4.3	13	2	2.69	12.49
KZI Bank	11	4	1	3	6	17	4.3	0.9	3.4	12	0	2.20	3.46
Al-Hilal" Islamic Bank	7	0	0	0	6	11	4.1	0	4.1	10	0	-1.40	-1.52
Shinhan Bank Kazakhstan	6	0	0	0	5	18	3.9	0	3.9	10	0	2.37	3.53
ICBC Almaty	16	0	0	0	6	30	3.3	0	3.3	11	0	1.61	4.58
National Bank of Pakistan in Kazakhstan	3	2	0	2	2	5	2.6	0	2.6	4	0	1.29	1.52
Senim-Bank	6	3	0.1	3	2	6	2.6	0.1	2.5	2	0	0.18	0.44
Danabank	6	2	0	2	5	12	1.2	0.1	1.1	10	0	-2.62	-3.16
TAIB Kazak Bank	6	1	0.1	1	4	6	1.1	0.2	0.9	4	0	-1.53	-2.54
Credit Altyn Bank	6	4	0	4	5	0						0.00	0.00
Subtotal	2,044	1,122	251	871	321	2,570	1,456	286	1,171	535	23	0.98	5.29
Market share	17%	12%		14%	24%	20%	14%		16%	41%	85%		
Total Second Tier Banks	12,038	9,065	2,802	6,263	1,323	12,822	10,443	3,336	7,107	1,305	27	0.21	2.02

Source: Financial Supervision Agency Data.

Table A4.4: Banks Grouped According to Profitability

Name of Bank	2010					2011						Return on	
	Total assets	Gross loans	Loss provisions	Net loans	Net worth	Total assets	Gross loans	Loss provisions	Net loans	Net worth	Net income	Assets (%)	Equity (%)
Home Credit Bank	19	14	0.8	13	7	45	33	1	32	13	6	18.74	62.09
Kaspi Bank	353	289	40.7	248	36	422	361	59	302	47	12	3.10	29.04
Eurasian Bank	359	228	23.5	205	26	370	270	27	243	32	7	1.82	22.85
HSBC Bank Kazakhstan	243	88	5.2	83	15	165	91	6	85	19	4	1.88	22.45
Sberbank	283	177	11.8	165	40	491	359	19	340	50	8	1.96	16.85
Citibank Kazakhstan	221	38	0.6	37	22	346	87	2	85	24	3	1.21	15.01
Tsesnabank	227	149	10.2	139	24	438	333	12	321	35	4	1.23	14.01
Halyk Bank	2,024	1,224	285.7	938	268	2,222	1372	325	1046	290	36	1.72	13.07
Bank of China Kazakhstan	55	3	0	3	12	59	4	0	4	13	2	2.69	12.49
Alfa-Bank	94	31	3.2	28	10	106	52	4	48	13	1	1.09	9.43
Subtotal 10 profitable banks	3,877	2,241	382	1,859	458	4,663	2,962	455	2,507	536	83	1.94	16.64
Market share	32%	25%	14%	30%	35%	36%	28%	14%	35%	41%	311%		
ICBC Almaty	16	0	0	0	6	30	3	0	3	11	0	1.61	4.58
Delta Bank	52	41	0.8	40	12	90	70	4	66	17	1	0.79	3.98
Bank CenterCredit	1,211	720	109.6	610	77	1,063	806	129	677	84	3	0.28	3.96
Shinhan Bank Kazakhstan	6	0	0	0	5	18	4	0	4	10	0	2.37	3.53
KZI Bank	11	4	1	3	6	17	4	1	3	12	0	2.20	3.46
Astana-Finance Bank	17	13	2	11	5	50	25	2	23	5	0	0.30	1.83
Eximbank Kazakhstan	84	67	8.3	59	13	86	66	11	55	14	0	0.27	1.72
Zaman-Bank	5	4	0.4	4	3	5	5	0	4	4	0	1.26	1.54
National Bank of Pakistan in Kazakhstan	3	2	0	2	2	5	3	0	3	4	0	1.29	1.52
Bank Kassa Nova	8	5	0.1	5	6	13	11	0	11	7	0	0.41	0.68
Kazinvestbank	64	50	7.1	43	10	78	60	10	51	8	0	0.09	0.67
KazInComBank	6	3	0.1	3	4	39	21	0	20	5	0	0.13	0.62
Senim-Bank	6	3	0.1	3	2	6	3	0	3	2	0	0.18	0.44
Kazkommertsbank	2,430	2,344	724.1	1,620	278	2,485	2268	788	1479	435	1	0.05	0.32
Subtotal 14 low profit earning banks	3,919	3,256	854	2,402	430	3,984	3,347	946	2,401	619	6	0.16	1.22
Market share	33%	36%	30%	38%	33%	31%	32%	28%	34%	47%	24%		
House construction saving bank of Kazakhstan	101	68	2.3	66	25	213	91	2	89	89	-1	-0.36	-0.99
Bank Pozitif	15	3	1.5	2	5	18	9	2	8	11	0	-0.71	-1.43
Al-Hilal" Islamic Bank	7	0	0	0	6	11	4	0	4	10	0	-1.40	-1.52
RBS (Kazakhstan)	120	14	0.7	13	19	135	17	1	17	20	0	-0.28	-1.83
Nurbank	261	201	84.6	116	44	267	222	94	128	71	-1	-0.41	-1.88
TAIB Kazak Bank	6	1	0.1	1	4	6	1	0	1	4	0	-1.53	-2.54
Danabank	6	2	0	2	5	12	1	0	1	10	0	-2.62	-3.16
AsiaCredit Bank	14	5	0.4	5	6	27	18	1	17	12	0	-1.93	-4.66
Metrocombank	19	8	1.5	7	7	35	13	2	11	9	-1	-3.75	-13.34
Bank VTB (Kazakhstan)	22	10	0	10	8	62	48	1	48	18	-2	-4.35	-14.07
ATF Bank	983	849	128.2	721	64	984	863	172	691	63	-37	-3.77	-58.36
Subtotal 11 loss-making banks	1,554	1,161	219	942	193	1,771	1,288	274	1,014	316	-43	-2.58	-16.86
Market share	13%	13%	8%	15%	15%	14%	12%	8%	14%	24%	-161%		
BTA Bank	1,994	1,645	921.8	723	181	1,617	2,090	1,303	787	-241	-23	-1.30	-79.09
Alliance Bank	490	546	318.9	227	34	530	535	242	293	9	n.a.	0.00	0.00
Temirbank	199	212	106.8	105	22	257	220	116	105	67	4	1.68	8.59
Subtotal 3 restructured banks	2,682	2,403	1,348	1,056	237	2,404	2,846	1,661	1,185	-165	-20	-0.77	-54.23
Market share	22%	27%	48%	17%	18%	19%	27%	50%	17%	-13%	-74%		
Total 38 Second Tier Banks	12,032	9,061	2,802	6,259	1,318	12,822	10,443	3,336	7,107	1,305	27	0.21	2.03

Source: Financial Supervision Agency Data.

Table A4.5: KazMicrofinance: Summarized Financial Statements 2007–2011 (tenge)

Balance sheets		2007	2008	2009	2010	2011
Assets:						
Cash/equivalents		239,636,000	177,520,000	1,981,614,000	367,977,000	395,842,000
Receivables		95,077,000	20,981,000	10,926,000	150,835,000	158,362,000
Loans out		6,467,916,000	5,496,263,000	4,631,219,000	5,370,808,000	7,799,997,000
Loss provisions		-73,356,000	-106,014,000	-75,214,000	-86,681,000	-85,395,000
Inventories		1,477,000	6,383,000	2,974,000	8,261,000	14,441,000
Tax assets			8,545,000	439,000	23,548,000	34,152,000
Intangibles		6,041,000	84,873,000	74,547,000	73,844,000	84,342,000
Other (balance item)		0	0	0	0	0
Fixed assets		544,556,000	590,917,000	554,879,000	618,002,000	734,116,000
Total assets		7,281,347,000	6,279,468,000	7,181,384,000	6,526,594,000	9,135,857,000
Liabilities:						
Borrowing		5,502,311,000	4,465,674,000	5,476,167,000	3,770,876,000	5,867,603,000
Subordinated debt		360,900,000	361,821,000	0	441,844,000	444,842,000
Other		63,815,000	67,749,000	77,383,000	133,622,000	181,343,000
Total liabilities		5,927,026,000	4,895,244,000	5,553,550,000	4,346,342,000	6,493,788,000
Net worth:						
Paid up capital		1,081,000,000	1,354,321,000	1,354,321,000	1,547,834,000	2,077,252,000
Retained earnings		273,321,000	29,903,000	273,513,000	632,418,000	564,817,000
Total net worth		1,354,321,000	1,384,224,000	1,627,834,000	2,180,252,000	2,642,069,000
Total liabilities & net worth		7,281,347,000	6,279,468,000	7,181,384,000	6,526,594,000	9,135,857,000
Income statements						
Revenues:						
Interest from loans out		1,526,099,000	2,315,108,000	2,094,316,000	2,203,775,000	2,879,751,000
Loan fees		97,354,000	144,158,000			
Other operating income		0	5,212,000	-664,000	3,962,000	-1,936,000
Investment interest						
Other		-111,000	13,616,000	15,626,000	19,956,000	22,719,000
Foreign Exchange gains/losses		-59,439,000	-18,912,000	-78,875,000	35,032,000	-4,735,000
Total revenues		1,563,903,000	2,459,182,000	2,030,403,000	2,262,725,000	2,895,799,000
Expenses:						
Cost of funds		351,314,000	745,998,000	655,649,000	465,679,000	559,100,000
Loss provisions		82,116,000	435,398,000	86,680,000	-47,382,000	-33,797,000
Operating expenses		707,097,000	1,081,336,000	1,003,622,000	1,153,698,000	1,801,366,000
Total expenses		1,140,527,000	2,262,732,000	1,745,951,000	1,571,995,000	2,326,669,000
Net operating income		423,376,000	196,450,000	284,452,000	690,730,000	569,130,000
Non-operating income		4,086,000	7,139,000			
Taxes		154,136,000	173,686,000	40,842,000	138,312,000	107,313,000
Net income		273,326,000	29,903,000	243,610,000	552,418,000	461,817,000
Data and ratios						
Capital Adequacy Ratio		19.2%	22.7%	31.3%	35.4%	30.2%
Expenses to Revenue Ratio		72.9%	92.0%	86.0%	69.5%	80.3%
Return on Equity Ratio		24.1%	2.2%	16.2%	29.0%	19.2%
Loan revenue/loans out		33.1%	41.1%	41.4%	44.1%	43.7%
Cost of funds/liabilities			13.8%	12.5%	9.4%	10.3%
Loss provision/average loans		1.7%	7.3%	1.7%	-0.9%	-0.5%
Operating cost/average loans out		14.4%	18.1%	19.8%	23.1%	27.4%
Loan portfolio/borrowing		1.10	1.14	0.85	1.27	1.24
Loan write-offs		21,032,000	430,459,000	171,139,000	47,889,000	64,001,000
Loans < 30 days			5,278,404,000	4,327,939,000	5,216,014,000	
Loans < 30 days	%		96.0	93.5	97.1	
Write-offs (previous year loans)	%		6.7%	3.1%	1.0%	1.2%
Total borrowers		28,005	27,022	23,962	30,740	46,612
Men borrowers		7,538	7,506	6,711	8,245	11,653
Women borrowers		20,467	19,516	17,251	22,495	34,959
Women %		73.1%	72.2%	72.0%	73.2%	75%

Source: Microfinance MIX Market. 2013. *KazMicroFinance Report.* Washington DC. http://www.mixmarket.org/mfi/kmf/report.

Table A4.6: Asian Credit Fund Summarized Financial Statements 2007–2011 (tenge)

Balance sheets		2007	2008	2009	2010	2011
Assets:						
Cash/equivalents		183,712,000	1,865,311	231,921,000	290,552,000	404,662,000
Receivables		9,911,000	96,720	6,728,000	14,009,000	14,415,000
Loans out		537,871,000	3,656,902	330,834,000	387,750,751	648,818,000
Loss provisions		-17,581,000	-378,735	-39,649,000	-21,413,000	-32,673,000
Inventories		191,000	0	5,332,000	8,075,000	2,033,000
Tax assets		5,761,000	0	12,964,000	2,014,000	2,041,000
Unearned income		0	0	0	3,563,751	11,673,000
Other		0	0	0	1,629,498	-11,199,000
Fixed assets		12,892,000	97,767	19,276,000	16,222,000	16,784,000
Total assets		732,757,000	5,337,965	567,406,000	702,403,000	1,056,554,000
Liabilities:						
Borrowing		544,366,000	4,691,927	487,556,000	630,970,000	975,478,000
Other		9,831,000	40,554	4,220,000	11,508,000	18,660,000
Total liabilities		554,197,000	4,732,481	491,776,000	642,478,000	994,138,000
Net worth:						
Paid up capital		103,372,000	980,656	115,688,000	195,922,000	195,922,000
Retained earnings		74,369,000	-375,172	-40,058,000	-135,997,000	-133,506,000
Reserves		819,000				
Total net worth		178,560,000	605,484	75,630,000	59,925,000	62,416,000
Income statements						
Revenues:						
Interest from loans out		138,954,000	1,219,979	141,812,000	221,948,000	326,724,000
Loan penalty fees		9,002,000	124,339	0	0	6,358,000
Other operating income		18,000	129,446	33,670,000	5,441,000	-1,497,000
Investment interest		2,589,000	28,030	0	15,151,000	20,610,000
Foreign Exchange gains/losses		5,036,000	-4,137	-20,468,000	1,245,000	-3,474,000
Total revenues		155,599,000	1,497,657	155,014,000	243,785,000	348,721,000
Expenses:						
Cost of funds		51,769,000	454,821	62,543,000	66,680,000	96,099,000
Loss provisions		6,041,000	439,768	32,670,000	-3,551,000	14,933,000
Operating expenses		94,241,000	966,284	137,353,000	183,357,000	232,317,000
Total expenses		152,051,000	1,860,873	232,566,000	246,486,000	343,349,000
Net operating income		3,548,000	-363,216	-77,552,000	-2,701,000	5,372,000
Non-operating income		10,107,000	0	0	0	0
Taxes		14,797,000	55,894	1,858,000	8,359,000	2,881,000
Net income		-1,142,000	-419,110	-79,410,000	-11,060,000	2,491,000
Data and ratios						
Capital Adequacy Ratio		32.5%	17.4%	22.5%	14.6%	9.6%
Expenses to Revenue Ratio		97.7%	124.3%	150.0%	101.1%	98.5%
Loan revenue/loans out		31.6%	0.5%	84.8%	61.8%	64.3%
Loans < 30 days		521,465,000	2,727,475	228,938,000	363,379,128	
Loans < 30 days	%	96.9%	74.6%	69.2%	93.7%	
Loans > 30 days		16,406,000	485,344	33,335,000	2,911,702	
Restructured loans			444,083	68,561,000	21,459,921	
Total borrowers		617	1,687	2,388	4,539	7,849
Women borrowers		408	1,489	2,297	4,495	7,810
Women %		66.1%	88.3%	96.2%	99.0%	99.5%

Source: Microfinance MIX Market. 2013. *Asian Credit Fund Report.* Washington DC. http://www.mixmarket.org/node/3490/report.

Table A4.7: Fund for Financial Support Agriculture Summarized Financial Statements 2007–2011 (tenge)

Balance sheets	2007	2008	2009	2010	2011
Assets:					
Cash/equivalents	1,176,051,000	3,714,878,000	948,634,000	2,568,318,000	7,745,507,000
Receivables	12,730,910,000	41,397,000	40,080,000	889,663,000	2,139,412,000
Loans out	3,846,248,000	7,181,585,000	9,508,668,000	10,350,398,700	15,472,684,000
Loss provisions	-163,576,000	-304,359,000	-704,503,000	-828,696,000	-1,018,002,000
Inventories	0	15,055,000	15,294,000	0	0
Tax assets	0	49,362,000	67,154,000	55,238,000	14,389,000
Unearned income	0	0	0	0	0
Other (balance item)	1,775,000	726,873,000	389,596,000	-304,687,700	-579,095,000
Fixed assets	120,982,000	472,838,000	591,089,000	566,232,000	545,176,000
Total assets	17,712,390,000	11,897,629,000	10,856,012,000	13,296,466,000	24,320,071,000
Liabilities:					
Borrowing	117,000,000	3,298,733,000	1,310,472,000	1,762,992,000	2,569,810,000
Other	12,313,353,000	40,458,000	51,283,000	49,346,000	152,748,000
Total liabilities	12,430,353,000	3,339,191,000	1,361,755,000	1,812,338,000	2,722,558,000
Net worth:					
Paid up capital	5,545,950,000	8,706,950,000	9,706,950,000	11,795,292,000	22,006,950,000
Retained earnings	-278,745,000	-163,344,000	-548,408,000	-344,497,000	-173,471,000
Reserves/other	14,832,000	14,832,000	335,715,000	33,333,000	-235,966,000
Total net worth	5,282,037,000	8,558,438,000	9,494,257,000	11,484,128,000	21,597,513,000
Total liabilities & net worth	17,712,390,000	11,897,629,000	10,856,012,000	13,296,466,000	24,320,071,000
Income statements					
Revenues:					
Interest from loans out	289,823,000	509,197,000	665,429,000	1,037,000,000	1,129,594,000
Loan penalty fees	5,029,000	22,861,000	58,310,000	0	0
Other operating income	60,833,000	128,247,000	44,432,000	46,683,000	5,120,000
Investment interest	55,285,000	91,365,000	61,086,000	81,754,000	75,870,000
Other	0	62,805,000	44,486,000	30,626,000	249,529,000
Foreign Exchange gains/losses	-16,000	-12,000	0	-98,000	0
Total revenues	410,954,000	814,463,000	873,743,000	1,195,965,000	1,460,113,000
Expenses:					
Cost of funds	710,000	1,859,000	195,327,000	77,092,000	115,642,000
Loss provisions	29,771,000	140,783,000	400,144,000	124,193,000	190,063,000
Operating expenses	386,882,000	544,962,000	681,129,000	744,057,000	930,508,000
Total expenses	417,363,000	687,604,000	1,276,600,000	945,342,000	1,236,213,000
Net operating income	-6,409,000	126,859,000	-402,857,000	250,623,000	223,900,000
Non-operating income					
Taxes	0	11,458,000	-17,792,000	46,712,000	56,274,000
Net income	-6,409,000	115,401,000	-385,065,000	203,911,000	167,626,000
Data and Ratios					
Capital Adequacy Ratio	31.9%	104.6%	95.8%	107.0%	130.3%
Expenses to Revenue Ratio	101.6%	84.4%	146.1%	79.0%	84.7%
Rreturn on Assets		1.7%	-4.3%	1.9%	1.0%
Loan revenue/loans out	9.4%	9.6%	8.7%	10.4%	8.7%
Cost of funds/liabilities		0.0%	8.3%	4.9%	5.1%
Loss provision/average loans		2.6%	4.8%	1.3%	1.5%
Operating cost/average loans out		9.9%	8.2%	7.5%	7.2%
Total borrowers		24,852	18,869	18,500	16,974
Men borrowers		14,170	11,854	12,120	8,894
Women borrowers		10,682	7,015	6,380	8,080
Women %		43.0%	37.2%	34.5%	47.6%
Legal entities			30	263	

Source: Microfinance MIX Market. 2013. *Fund for Financial Support Agriculture Report.* Washington DC. http://www.mixmarket.org/mfi/ffsa/report.

Table A4.8: ORDA Credit Summarized Financial Statements 2009–2011 (tenge)

Balance sheets	2009	2010	2011
Assets:			
Cash/equivalents	274,940,000	58,502,000	324,808,000
Receivables	312,435,000	1,252,353,000	391,206,000
Loans out	3,760,065,000	3,307,721,026	3,724,655,000
Loss provisions	0	-155,199,026	-136,645,000
Other (balance item)	451,151,000	285,981,000	622,380,000
Fixed assets	289,540,000	351,594,000	444,995,000
Total assets	5,088,131,000	5,100,952,000	5,371,399,000
Liabilities:			
Borrowing	2,474,157,000	2,770,808,000	4,095,132,000
Deposits	503,632,000	86,776,000	51,551,000
Other	48,227,000	49,977,000	141,169,000
Total liabilities	3,026,016,000	2,907,561,000	4,287,852,000
Net worth:			
Paid up capital	1,517,000,000	1,517,000,000	617,000,000
Retained earnings	132,858,000	376,165,000	374,201,000
Reserves/other	412,257,000	300,226,000	92,346,000
Total net worth	2,062,115,000	2,193,391,000	1,083,547,000
Total liabilities & net worth	5,088,131,000	5,100,952,000	5,371,399,000
Income statements			
Revenues:			
Interest from loans out	743,528,000	695,580,000	808,246,000
Loan penalty fees	42,098,000	4,913,000	2,899,000
Other operating income	33,451,000	53,086,000	102,262,000
Investment interest	0	0	0
Other	206,016,000	31,888,000	74,350,000
FX gains/losses	-309983000	104,932,000	21,031,000
Total revenues	715,110,000	890,399,000	1,008,788,000
Expenses:			
Cost of funds	295,239,000	377,330,000	452,810,000
Loss provisions	42,464,000	20,186,000	53,106,000
Operating expenses	192,416,000	205,588,000	275,204,000
Total expenses	530,119,000	603,104,000	781,120,000
Net operating income	184,991,000	287,295,000	227,668,000
Non-operating income	0	222,000	0
Taxes	53,856,000	64,525,000	47,755,000
Net income	131,135,000	222,992,000	179,913,000
Ratios and data			
Capital Adequacy ratio	42.8	43.5	21.5
Expenses to Revenue Ratio	74	68	77
Return on Equity Ratio		10.5	11.0
Loan revenue/loans out		19.7	23.0
Cost of funds/liabilities		12.7	12.6
Loss provision/average loans		0.57	1.51
Operating cost/average loans out		5.82	7.83
Total borrowers	1,952	3,281	6,716
Women borrowers	1,371	1,969	2,787
Legal entities	29	68	
Percent women borrowers	70	60	42

Source: Microfinance MIX Market. 2013. *Orda Credit Report.* Washington DC. http://www.mixmarket.org/mfi/orda-credit/repor