

# Banking and Finance in Kazakhstan

## Banking sector

Since 1993, the Kazakh banking system has been formally arranged into two tiers, with the National Bank of Kazakhstan (NBK) comprising the first tier and all commercial banks, both private and state-owned, comprising the second tier.

NBK acts as a regulator of monetary and credit policy. NBK is accountable directly to the President of the Republic of Kazakhstan. The National Bank of Kazakhstan is an independent financial institution. Its major objectives include control and prudential regulation of the banking sector and maintenance of a stable national currency. It is independent within the scope of its activity, identified by current legislation. Neither the Government, nor the Parliament or local authorities are authorized to interfere with the National Bank's operations. The National Bank, however, co-ordinates its activities with the Cabinet of Ministers. It acts as a bank, a financial adviser, or an agent of the governmental bodies. The management bodies of the National Bank are the Council and the Board of Directors.

The Kazakhstan banking system continues to be one of the strongest among the countries of the former Soviet Union. Total banking assets hover around 10% of GDP, and the National Bank of Kazakhstan commands sufficient resources to support the country's commercial banks. Consolidation in the banking sector continues, with liquidation of insolvent banks, privatization and mergers of others.

Restructuring of the state-controlled banking and financial systems that Kazakhstan inherited in 1991 has been a long, and slow process. The National Bank continues to dominate the financial system, including currency management.

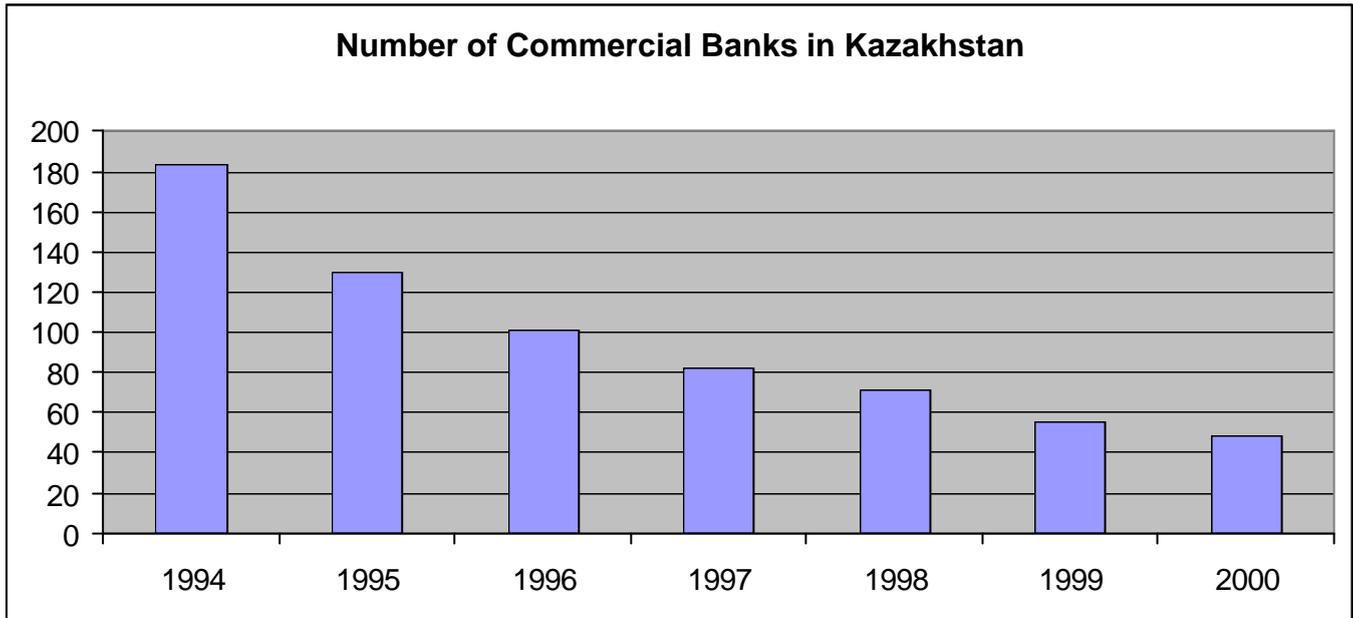
During the period of 1991-1993 Kazakhstan, as well as other CIS countries experienced the banking boom. In 1992, the number of banks grew from 155 (with 877 branches) to 204 (with 1023 branches). Many of these structures were created for just one type of transactions. An especially popular scheme was the attraction of state loans of several millions dollars with the initial malicious plan to go bankrupt.

The year 1993 was crucial for the country's banking system development. Kazakhstan's banking industry was created on the basis of a subsequently modified law enacted in April 1993. That law created a central institution, NBK, which has regulatory authority over a system of state, private, joint-stock, and joint banks. Licensed banks are authorized to perform all of the traditional banking functions.

The national currency, tenge, was introduced in November 1993. The National Bank itself took the helm of the country's monetary and credit systems. Its first action was strengthening requirements for the second-tier banks. In 1993 the National Bank withdrew first 15 banking licenses for non-compliance to these requirements. At the same time economic sanctions on possible defaults were introduced, as well as the requirement for the minimum charter capital. It should be noted that it took some time for banks to get accustomed to the new rules. During 1993 only 10% of the total number of banks met the new requirements. During the following years, the number of second-tier banks in Kazakhstan gradually decreased. Capitalization and liquidity requirements were also increased. Finally, all these measures had to ensure both the safety of deposits in Kazakhstan banks and the reliability of transactions and other banking operations.

NBK divided all second-tier banks into two groups according to the date by which they were expected to meet international banking standards. The first group was expected to participate in a deposit insurance fund. As a result, the banking sector has gradually become more stable and professional.

At the start of 2001, there were 48 banks, down from 71 at the end of 1998 and from over 200 at the peak in 1993. The 11 banks included in the first group were required to reach international standards by 1998. An audit is being conducted to verify whether these 11 banks have complied with these obligations. In addition, 24 banks belonging to the second group were expected to accomplish the same transition by the end of 2000. Further consolidation is expected as many remaining banks will have been unable to comply with the increased minimum capital requirement of KZT 1 billion (about US\$6.9 million) by the end of 2000.



The sector remains concentrated, with the four largest banks (Kazkommertsbank, Halyk Savings Bank, Bank TuranAlem and the Dutch ABN Amro) accounting for about 60% of total sector assets and about 63% of deposits. Halyk Savings Bank Kazakhstan (HSBK) has the most developed retail network in Kazakhstan, which includes more than 1143 structural units. It's the only bank that has branches in rural areas. The Bank offers a full range of banking services to its clients and has established relations with many financial institutions. The main goal of HSBK is carrying out the agent role for the Government of the Republic of Kazakhstan. The Bank is the leader in implementation of state programs for financing the real sector of the country's economy. The Bank is the only operator of the government on agriculture financing. Moreover, Halyk Savings Bank of Kazakhstan is a single operator of the Government of the Republic of Kazakhstan on agriculture financing. Moreover, the Bank has been implementing its own program on Small and Medium Agribusiness Financing.

Some foreign banks, most notably Citibank (US), have been aggressively entering the Kazakh market and have been successful in capturing blue chip companies away from the local banks. Smaller Kazakh banks with limited capital resources and less expertise have consequently seen their market shares decreasing. Competition will continue to increase, particularly from foreign banks, but also from domestic private pension funds, which create strong demand for domestic bonds and therefore compete with banks in lending.

Despite rapid recent growth in bank assets, the country remains under banked in terms of assets and loans to GDP. In particular, over the coming years and consumer lending, as well as lending to micro and small enterprises (MSEs). Banks are introducing new products, such as mortgages, leasing and consumer financing. Further foreign investment is also expected in the sector as competition and consolidation proceeds.

## **Non-bank financial institutions**

### **The Kazakh Stock Exchange**

Kazakhstan adopted laws that regulate emission of securities, as well as trading rules and regulation of operations in the stock market, supervising government agencies, etc. However, the legislation is still to be adapted to changing market conditions as the stock market is at early stages of its development.

National Bank of Republic of Kazakhstan is a supervising body for operations on the stock market (formerly these activities were under control of National Commission on Securities). There are a number of dealers and brokers, working primarily on the currency market. Kazakhstan Stock Exchange and Central Depository are vital parts of the stock market.

The stock exchange is relatively advanced as compared to those in neighboring countries. However, the Russian crisis brought the state securities market to an almost complete standstill, while trading of corporate securities has traditionally been minimal and barely reached US\$30 m in 1999, up from US\$7 m in 1998. However, demand for government paper has been picking up strongly since early 2000 and yields have come down rapidly to around 13% (for six-month maturities) since June 2000. Therefore, the Kazakh Stock Exchange solidified its position in 2000, and more issues are expected in 2001. Increased minimum capital requirements for the banking sector are expected to lead to more stock issues by banks. The government is also encouraging local companies to raise capital by launching new issues. Domestic bond issues by two banks on the Stock Exchange are a case in point.

#### **The following objectives were set up for the industry:**

- Development of domestic institutional investors;
- Increase investment attractiveness of non-government securities;
- Balancing of demand for and supply of securities;
- Launch a state-wide transfer-agent net for the market participants;
- Ensure informational transparency and equal access to information for all types of investors;
- Develop a system for state regulation of securities, which would ensure protection of rights and interests of investors.

Other non-bank financial institutions are underdeveloped. Leasing is not readily available and the insurance sector is at an early stage of development. Recently introduced laws for regulation of insurance and leasing activities have yet to be put to the test to demonstrate that they provide the basis for a sound non-bank financial institutions sector. This will promote diversification of activity within the financial sector.

## **Insurance sector**

There are currently about 70 insurance companies, three of which are state-owned, and nine of which have foreign participation. One of the largest insurance companies, AIG Kazakhstan, is a joint venture between the American International Group and the local Rakhat group. KazkommertsBank and Turan Alem Bank also have their local subsidiaries or divisions operating in the insurance sector. Although initially all transactions related to property and accident insurance, the recent introduction of a car insurance system has helped the sector to expand further.

Most insurance companies are located in Almaty. They are registered as joint-stock companies; there is one limited liability partnership (TOO "IC Medeu"), and one republican state enterprise (RGSSP "Kazagropolis"). Life insurance market is relatively undeveloped and is going through a period of rapid expansion.

Aggregate authorized capital of insurance companies is increasing as requirements of the National Bank became stricter after Resolution of the Board of the National Bank of the Republic of Kazakhstan no. 355 dated November 15, 1999. Resolution stipulates «Minimal Sizes of Authorized and Capitals of Insurance and Reinsurance Organizations» registered in the Ministry of Justice of the Republic of Kazakhstan on December 15, 1999 under 1998.

The share of total registered authorized capital of insurance organizations with foreign participation in aggregate registered authorized capital of all insurance organizations amounted to 310 million tenge or 9% in 2000.

## **Pension funds**

Since reforms of the pension sector, pension funds and asset managers have developed dynamically. By early 2001 pension funds had accumulated around US\$800 m in contributions since the start of the fully funded system in January 1998. Starting from 1999, private pension funds have become a competitive force on the segment of large blue chip companies. The doubling of minimum capital requirements for private funds to KZT 180 m in August 2000 has led to the forced merger of two of the 15 private funds with stronger institutions. Well over half of all contributions are now invested in private funds. However, the transferability of individual accounts between funds remains low.

Following the successful pension reform in 1998, private pension companies are receiving substantial mandatory pension payments, which through asset managers they are required to invest in assets meeting relatively stringent risk and liquidity parameters. Presently, the government securities market attracts the largest share of pension fund liquidity, but the continuing decline in yields on state instruments is leading to growing interest among pension fund managers in blue chip domestic corporate bonds. There were 14 new issuances of domestic bonds worth about US\$ 200m in 2000. Since the demand for this type of paper exceeds its supply, interest rates are beneficial to the issuers and offer direct competition with unsecured bank debt.