

THE BANKING
REGULATION
REVIEW

THIRTEENTH EDITION

Editor
Jan Putnis

THE LAWREVIEWS

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PREFACE

The past year in banking regulation has been dominated, in most parts of the world, by the severe economic effects of the coronavirus pandemic. Governments and regulators have taken unprecedented steps to support businesses and individuals through the crisis. In financial terms, much of this support has been channelled through banks, and banks have had to work hard to continue to lend and to serve their customers in this difficult period.

Despite the human suffering and long-term economic damage that the pandemic has caused, there has been no significant banking crisis in the past year and, in most countries, no real sign that banks are failing to weather the storm so far. While there are of course exceptions, this is in large part a consequence of the relatively strong capital and liquidity position that banks around the world were in before the pandemic struck, which was itself a position that would not have arisen in many countries without the comprehensive prudential regulatory reforms that followed the global financial crisis of 2007–2009. Indeed, some regulators have commented that the pandemic is proving to be the first real test of those reforms and that, at least so far, the rules and institutional frameworks for banking regulation that were created after the global financial crisis have proven their worth.

As in all ongoing crises, there are causes for both pessimism and optimism. A pessimistic assessment with which it is hard to argue in many parts of the world is that we are still at an early stage in the economic damage that the pandemic has caused. The gradual withdrawal of government support programmes for businesses and the consequent further increases in non-performing loans with which banks have to deal will pose a further severe test for the banking systems of many countries at a time when governments will be relying on banks to support economic recovery. In some countries the strong links between bank viability and the ability of governments to issue sovereign debt at sustainable interest rates may re-emerge as a significant problem.

The optimistic assessment is necessarily a longer-term one given the challenges that the pandemic continues to present. The pandemic has undoubtedly provided the banking sector with an opportunity to show that it can be a force for financial stability and economic renewal at a time of crisis, in marked contrast to the blow to confidence that the sector suffered following the global financial crisis. This opportunity is closely linked to moves by many banks to consider their corporate purpose, the sustainability of their activities in environmental and social terms, and the quality, and in many cases the diversity, of their governance. This somewhat disparate collection of objectives, referred to as ESG (for environmental, social and governance) in many parts of the world, is increasingly dominating discourse between banks and their regulators and investors. Whether this would have happened in quite the way it has without the pandemic is impossible to know, but it does not seem much of an exaggeration

to suggest that in many countries the banking sector that will emerge from the pandemic will have a series of cultural and business objectives that are quite different from those that existed before.

Regulators have become more assertive on these matters, particularly with regard to environmental objectives, and we will increasingly see a harder edge to the expectations that they are forming of banks' adherence to policies designed to address climate change. The repricing of many risks that is expected to take place as opinion settles on the pace at which transition to a low-carbon economy should take place will have a profound effect on the balance sheets of many banks. Shareholder pressure will force change in some banks, and banks with significant exposure to the petroleum economy will have to consider radical changes to their business models.

On social matters, financial inclusion and fair treatment of vulnerable customers are motivating legal and regulatory reform in many countries. There is a strong link between financial inclusion and the adoption of new technologies and business models, particularly in payment services. Many of the businesses that are contributing to the adoption of these technologies are not banks but rely on banks (or payment systems that are owned or controlled by banks) in order to operate. Allied to this are the increasingly serious and well-resourced attempts by firms using distributed ledger technologies to develop new means of payment, including stablecoins.

Regulators struggle to keep pace with these developments, but they hold back at their peril on addressing the implications for banks. The concept that the same or similar services and activities should be regulated in the same way is proving to be difficult to apply in practice, not least because there is a fundamental difference in financial stability terms between institutions that take deposits and those that do not. But the challenge of how to establish a level playing field on which to supervise banks and non-bank payment firms and lenders is one that must surely be addressed, and addressed soon, by regulators in a coordinated way around the world. The time for regulators to congratulate themselves on the effectiveness of financial sector reform following the global financial crisis has come to an end. It is now time to think hard about where risks lie and how risks will develop in the emerging tech-enabled financial system, and the possible causes of the next financial crisis.

It is perhaps surprising, given all the disruption caused by covid-19, that some countries have managed to push through significant legal and regulatory reforms in banking in the past year. These measures have included significant overhauls of the whole bank regulatory regime in some countries and, in other countries, further moves to implement Basel III standards. We have already seen some important changes of policy and emphasis in the United States under the new Biden administration. Legal and regulatory reform has continued in the European Union, although many initiatives have been delayed by the pandemic. The final departure of the United Kingdom from the European Union single market on 31 December 2020 and the resulting decoupling of London as a major banking centre from the European Union legal framework will continue to have reverberations and structural implications for banks operating in Europe. The long-term implications of Brexit for banks remain hard to predict; in particular, whether it will be a prelude to further fragmentation in banking regulation around the world.

This edition of *The Banking Regulation Review* covers 33 countries and territories in addition to the usual chapters on International Initiatives and the European Union. My thanks go to the authors for continuing to prepare informative chapters in the difficult and

uncertain conditions in which many of them have been working over the past year. They continue to make this book the useful overview and guide to banking regulation around the world that it is.

Thank you also to the partners and staff of Slaughter and May in London and Hong Kong for continuing to support and contribute to this book, and in particular to Nick Bonsall, Ben Kingsley, Peter Lake, Emily Bradley, Ben Goldstein, Selmin Hakki, David Kasal, Tolek Petch, David Shone, Adrien Yeung and Ada Zhang.

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Jan Putnis

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KAZAKHSTAN

Marina Kahiani

I INTRODUCTION

Events in 2021 resulted in the Kazakh economy, in particular the financial sector, having to face the combined challenge of a continued reduction in oil prices and new strains of covid-19. However, according to the Agency for Regulation and Development of the Financial Market (AFR), the negative impact of these challenges on the Kazakh banking sector was not as severe as expected, and in 2021 banking sector started gradually to recover. In 2021, annual lending to the Kazakh economy amounted to 18.5 trillion tenge, which was a 26.5 per cent increase on the previous year. The net income of banking sector increased by 77.6 per cent as compared with the previous year.² The level of non-performing loans decreased from 6.8 per cent to 3.9 per cent in 2021.³ The beginning of 2022 added new challenges, such as unrest in Almaty in January and war in Ukraine with subsequent sanctions upon Russia, which will definitely impact Kazakhstan due to close connection of Kazakhstan's economy with Russia's economy. Local currency has already dropped dramatically. Time will test the stability of the Kazakh banking system in the face of these unprecedented challenges.

The Kazakh banking services market is represented by various players, including banks, organisations that perform certain types of banking operations (banking organisations), payment services providers and microfinance organisations (MFOs). In line with the global trend, fintech companies are also becoming crucial players in the market. Banks operating in Kazakhstan include local banks (conventional and Islamic) and subsidiaries of foreign banks operating as Kazakh legal entities under Kazakh law. Following recent law amendments, foreign banks can now carry out banking business not only through their subsidiaries but also through branches, which was previously prohibited. There are currently 22 banks in Kazakhstan; of these, 14 banks have foreign participation, including 11 subsidiary banks, and one bank is 100 per cent owned by the state.⁴ The top five banks by assets are Halyk Bank, Sberbank, Kaspi Bank, Otbasy Bank and First Heartland Jysan Bank.⁵

1 Marina Kahiani is a partner at GRATA International.

2 <https://halykfinance.kz/research/banki-kazahstana-v-2021-godu.html?lang=ru>.

3 <https://kapital.kz/finance/101619/v-2021-godu-bankovskiy-sektor-kazahstana-lishilsya-chetyrekh-igrokov.html>.

4 <https://www.gov.kz/memleket/entities/ardfm/documents/details/271028?lang=ru>.

5 As at January 2022; https://bankchart.kz/spravochniki/rejtingi_cbr/2/2022/1.

II THE REGULATORY REGIME APPLICABLE TO BANKS

i Regulators

There are three financial regulators in Kazakhstan: the AFR, the National Bank of Kazakhstan (NBK) and the Astana Financial Services Authority (AFSA). The AFR is responsible for the regulation of banks, branches of foreign banks, banking organisations, MFOs, insurance organisations, pension funds and securities market subjects. The NBK, as the central bank of Kazakhstan, is responsible for monetary policy, stability of financial and payment systems, currency control and regulation, and regulation of payment systems, payment system operators and payment organisations. The AFSA regulates financial and payment services provided within the Astana International Financial Centre (AIFC) framework; namely, the financial and payment services provided by AIFC entities to other AIFC entities.

ii Key players in Kazakhstan's banking business

Banking business in Kazakhstan is made up of banks, banking organisations, MFOs and, more recently, fintech companies (without banking licences) that provide traditional banking services, such as payments and transfers of money. In addition, some special entities (mostly quasi-state) (e.g., the Development Bank of Kazakhstan, the national post operator, KazPost, and Agrarian Credit Corporation) can also conduct banking operations without a banking licence provided that authority is expressly granted to them by the legislation.

Banks and banking organisations

Banks and banking organisations can perform banking activity based on licences issued by the AFR or the NBK, or the AFSA for banks established and operating within the AIFC. The list of banking operations permitted for each particular bank or banking organisation is detailed in its banking licence. Banks are generally prohibited from performing any type of business activity other than banking activity, subject to certain exceptions. Banks, banking organisations and their shareholders are also subject to stringent regulatory requirements, including a minimal regulatory capital requirement, prudential ratios and other norms, requirements in terms of management and premises, and assets in which they are permitted to invest.

Islamic banks

In Kazakhstan, local Islamic banks and branches of foreign Islamic banks can operate alongside conventional banks. Islamic banks are subject to separate regulation by the AFR. Generally, they are prohibited to charge interest on loans and pay guaranteed interest on deposits. Islamic banks are prohibited from investing in businesses related to tobacco, alcohol, weapons, gaming and certain other activities prohibited by the Council on principles of Islamic financing (the Islamic Council). The Islamic Council is a mandatory corporate body of an Islamic bank that determines key issues of the bank's activity, including permitted transactions, rules of conduct and internal credit policies.⁶

⁶ Article 52-1 and 52-2 of Law No. 2444 of the Republic of Kazakhstan, dated 31 August 1995, on banks and banking activity in the Republic of Kazakhstan (the Banking Law).

Branches of foreign banks

Since December 2020, branches of foreign banks have been allowed to perform banking business in Kazakhstan, subject to extensive AFR requirements.

MFOs

MFOs hold a solid position in the Kazakh financial market. Following recent law amendments, only MFOs, pawnshops and credit partnerships are entitled to issue microcredit. Microlending activity by any other legal entities is prohibited.

Fintech companies

Fintech companies are becoming key players in the financial services market. Initially, fintech companies in Kazakhstan operated in the microlending and payments sphere. However, in 2020, the regulator forced companies providing online loans to undergo reregistration as MFOs, which are subject to regulation by the AFR. Consequently, most fintech companies now operate in the payments sphere only. As at February 2022, there were 81 payment organisations in Kazakhstan.⁷ According to the NBK, in 2021, the value of cashless payments increased by 2.1 times to 73.1 trillion tenge.⁸

Payment systems

The payments industry in Kazakhstan is represented by both local payment systems, such as the interbank payment system operated by the NBK, and international payment systems, such as Mastercard, Visa and UnionPay. Payment systems provide payment infrastructure and various high-technology services associated with payments to Kazakh banks. Operators of foreign payment systems must notify the NBK on commencement of their operations in Kazakhstan and must comply with general requirements of Kazakh law, such as regarding reporting, personal data and antitrust regulation. However, as yet there is no detailed regulation applicable to foreign payment systems and their services, which provides them with great opportunities in the Kazakh market.

Cross-border lending to Kazakh borrowers by foreign banks

In practice, it is common for Kazakh borrowers to attract financing from foreign banks that have no presence in Kazakhstan on a cross-border basis. The provision of a loan or other financial service by a foreign bank located outside Kazakhstan to a Kazakh customer is, generally, not considered as banking activity for the purposes of Kazakh law and, accordingly, can be performed without a Kazakh banking licence. However, foreign banks that intend to market and provide loans and other services to Kazakh customers on a cross-border basis must take into account mandatory provisions of Kazakh law, such as advertising restrictions, securities market regulation and currency control regulation.

7 https://nationalbank.kz/ru/links/platezhnye_sistemy.

8 <https://profit.kz/news/62310/Nacbank-RK-platezhnie-karti-itogi-2021/>.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The key prudential regulator of banks and other financial institutions in Kazakhstan is the AFR, whereas the NBK, as mentioned above, still provides regulation on certain matters. Prudential regulation within the AIFC is provided by the AFSA.

On 1 January 2019, the NBK (which regulated the financial sector at the time and has subsequently transferred relevant functions to the AFR) introduced the 'risk-oriented approach' to financial sector regulation. A risk-oriented approach means that certain financial institutions that play a key or substantial role in the financial market are subject to stricter supervision by the AFR than smaller players because misconduct or default by major institutions may significantly affect the whole financial market. At the same time, smaller players with less importance for the whole market are subject to less attention and more simplified supervision by the AFR. The risk-oriented approach is based on the principles of the law (spirit of the law) rather than on formal compliance with the law (letter of the law).

One of the main elements of the risk-oriented approach is the concept of 'motivated judgement'. Motivated judgement means that in certain cases, the AFR can, based on its professional assessment, identify the risks and apply regulatory measures and sanctions to financial sector entities even where these entities are, technically, in full compliance with the law. The list of cases in which the AFR is entitled to use motivated judgement is relatively broad and includes, *inter alia*:

- a* assessment of a financial institution's financial position;
- b* identification of related-party transactions and transactions concluded by a bank on favourable conditions;
- c* assessment of a financial institution's risk management and internal control systems; and
- d* assessment of a financial institution's adequacy of provisions (reserves).⁹

As an example, in the case of Tengri Bank, the regulator identified (with the use of motivated judgment) that 58 per cent of the bank's loans were issued to related parties,¹⁰ although the borrowers were not documented as being formally affiliated to the bank. As a result, Tengri Bank's banking licence was withdrawn and it is currently in the process of compulsory liquidation.

The introduction of motivated judgement as a part of the risk-oriented approach has been criticised by some members of the banking community for giving the regulator the possibility to apply regulatory measures to financial sector players at its own discretion and without any precise legal basis.

The AFR regulates banks on both an individual and consolidated basis (i.e., not only the banks themselves, but also their shareholders and affiliates are subject to supervision and regulatory measures applied by the AFR); for example, if deterioration of a bank's financial position becomes apparent, the AFR can request shareholders of the bank holding 10 per cent

⁹ Article 13-5 of Law No. 474-II of the Republic of Kazakhstan, dated 4 July 2003, on state regulation, control and supervision of financial market and financial organisations (the Financial Market Regulation Law).

¹⁰ www.kapital.kz/finance/90034/u-aktsionerov-tengri-bank-ne-bylo-soglasovannogo-plana-deystviy.html.

or more of the voting shares to provide additional capital and take other measures.¹¹ Banks and their shareholders are subject to extensive disclosure requirements, including the obligation to disclose the following to the AFR and the NBK:

- a* financial statements;
- b* information on compliance with prudential ratios;
- c* accepted risks and measures relating to risk and capital management;
- d* related parties and transactions with them;
- e* management's qualifications and experience; and
- f* other information relating to the banking activity.

ii Management of banks

Banks in Kazakhstan (except for in the AIFC, which is, effectively, a separate jurisdiction and has its own banking regulation) can only be established as joint-stock companies. Accordingly, general requirements to corporate structure and corporate governance applicable to any Kazakh joint-stock company shall apply to a Kazakh bank, subject to certain special requirements of the Banking Law. The bank is required to have a general shareholders' meeting, a board of directors, a management board and a CEO. Credit committees and internal audit services are mandatory corporate bodies for Kazakh banks.¹²

Most of a bank's decisions, including decisions on banking transactions, are taken by the board of directors and management board rather than by a general meeting of the shareholders or the sole shareholder. Members of the board of directors and management board are generally liable to the bank and its shareholders for harm caused by their actions, or for failure to act, and damage caused to the bank, including for the approval of a major or related-party transaction that is harmful to the bank.¹³ There is also criminal liability for the intentional insolvency of a financial organisation,¹⁴ abuse of power¹⁵ and some other breaches committed by the management of financial organisations, including banks.

Managing employees of banks include members of the board of directors, and the management board, as well as other managing employees who provide coordination or control over the bank's activity and have the authority to sign documents upon which banking operations are based.¹⁶ The Banking Law establishes certain qualification requirements for managing employees of banks, including their education and work experience and the requirement for them to have an impeccable business reputation. The appointment of managing employees of banks is subject to AFR permission.

Banks must disclose to the NBK the total amount of remuneration paid to managing employees in each financial year.¹⁷ Bonuses of top management of Kazakh banks can be provided as cash payments or shares, or both. Certain parts of bonuses shall be retained by the bank for at least three years and can be partially paid to managing employees each

11 Article 42.5 of the Banking Law.

12 Article 26.2 of the Banking Law.

13 Article 63 of Law No. 415-II of the Republic of Kazakhstan, dated 13 May 2003, on joint stock companies (the JSC Law).

14 Article 239 of the Criminal Code of the Republic of Kazakhstan (No. 226-V), dated 3 July 2014 (the Criminal Code).

15 Article 250 of the Criminal Code.

16 Article 20.1 of the Banking Law.

17 Article 20.2 of the Banking Law.

financial year provided that the bank has suffered no losses in that financial year. If bonuses are provided as shares, the relevant managing employee shall keep these shares in his or her ownership for at least three years.¹⁸

iii Regulatory capital and liquidity

Since 2013, Kazakhstan has gradually been implementing international banking standards provided by Basel III. Namely, the notion of 'basic capital' has been introduced, termless contracts and preferred shares are gradually being excluded from Tier 1 capital, subordinated debt is included in the calculation of Tier 2 capital and capital buffer requirements have been introduced. Full transfer to Basel III standards is expected in 2022.

The Banking Law establishes a number of mandatory prudential ratios applicable to Kazakh banks, including:

- a* minimal charter capital of the bank;
- b* minimal own capital of the bank;
- c* capital adequacy ratio;
- d* maximum risk per borrower;
- e* liquidity ratios;
- f* ratio of capital to the bank's obligations to non-residents; and
- g* ratio of placement of the bank's funds to local assets.¹⁹

In addition, the AFR is entitled to establish additional prudential ratios and other norms used in international banking practice;²⁰ for example, as part of the implementation of the Basel III standards, the AFR introduced a liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) that aim to ensure sufficient liquidity of Kazakh banks.

Regulatory capital

The minimum charter capital and minimum own capital of newly established banks must each be at least 10 billion tenge.²¹

In line with Basel III international standards, banks' capital adequacy in Kazakhstan is assessed based on the following ratios:

- a* basic capital adequacy ratio, K1 (not less than 5.5 per cent);
- b* Tier 1 capital adequacy ratio, K1-2 (not less than 6.5 per cent); and
- c* Tier 2 capital adequacy ratio, K2 (not less than 8 per cent).²²

Ratio K1 is calculated as the ratio of basic capital (sum of ordinary shares, undistributed profit and reserves minus own redeemed shares, non-material assets, losses, deferred tax

18 Resolution No. 74 of the NBK, dated 24 February 2012, on approval of requirements to internal policy of employment remuneration, accrual of cash remuneration and other types of material incentives of managing employees of a bank, insurance (reinsurance) organisation and insurance broker.

19 Resolution of the Management Board of the NBK No. 170, dated 13 September 2017, on approval of prudential ratios and calculation methods of prudential ratios and other mandatory norms and limits, bank's capital and rules for calculation and limits of open currency position (the Prudential Ratios Resolution).

20 Article 42.1 of the Banking Law.

21 Article 3 of the Prudential Ratios Resolution.

22 Article 6 of the Prudential Ratios Resolution.

assets and certain other regulatory corrections) to the sum of: (1) assets and conditional and possible obligations weighted by credit risk; (2) assets and conditional and possible claims and obligations weighted by market risk; and (3) operation risk. These are collectively referred to as risk-weighted assets.

Ratio K1-2 is calculated as the ratio of Tier 1 capital (basic capital plus additional capital) to risk-weighted assets, and ratio K2 is calculated as the ratio of own capital to risk-weighted assets. The reserves kept by banks in accordance with the International Financial Reporting Standards shall be deducted from the risk-weighted assets when calculating capital adequacy ratios.

In addition to the above ratios, the following own capital buffer requirements have been established for Kazakh banks in line with Basel III:

- a* capital conservation buffer;
- b* countercyclical buffer;
- c* systemic buffer; and
- d* regulatory buffer.

Liquidity

The liquidity of Kazakh banks is assessed by the AFR based on the following ratios:

- a* current liquidity ratio, K4 (not less than 0.3);
- b* term liquidity ratios, K4-1, K4-2 and K4-3 (not less than 1, 0.9 and 0.8, respectively);
- c* term currency liquidity ratios, K4-4, K4-5 and K4-6 (not less than 1, 0.9 and 0.8, respectively);
- d* LCR (not less than 0.9 until 31 December 2021 and not less than 1 from 1 January 2022);²³ and
- e* NSFR (not less than 1).²⁴

K4 is calculated as the ratio of the bank's average monthly highly liquid assets (HLA) to the average monthly demand obligations and accrued interest. K4-1 is calculated as the ratio of average monthly HLA to the average monthly term obligations with outstanding maturity of up to seven days. K4-2 is calculated as the ratio of the average monthly liquid assets with outstanding maturity of up to one month (including HLA) to the average monthly term obligations with outstanding maturity of up to one month. K4-3 is calculated as the average monthly liquid assets with outstanding maturity of up to three months (including HLA) to the average monthly term obligations with outstanding maturity of up to three months.²⁵ K4-4, K4-5 and K4-6 are calculated for relevant foreign currency in the same way as K4-1, K4-2 and K4-3, respectively.²⁶

23 Article 79 of the Prudential Ratios Resolution.

24 Articles 82 and 61 of the Prudential Ratios Resolution.

25 Article 62 of the Prudential Ratios Resolution.

26 Article 63 of the Prudential Ratios Resolution.

LCR and NSFR have been introduced in Kazakhstan as part of the implementation of the Basel III standards. LCR is calculated by dividing the HLA at the calculation date by the bank's net cash outflow during the calendar month following the calculation date.²⁷ NSFR is calculated by dividing the available stable financing by the required stable funding.²⁸

Consolidated supervision

The AFR performs both individual supervision over activity of the banks themselves and consolidated supervision over activity of banking conglomerates.²⁹ A banking conglomerate is a group of legal entities including the bank itself and its subsidiaries, bank holding companies (shareholder with a stake of 25 per cent or more of voting shares) and subsidiaries (if any), and legal entities in which the bank or bank holding company owns 20 per cent or more of voting shares.³⁰ Accordingly, capital and liquidity requirements are also assessed by the AFR on a consolidated basis. The AFR is entitled to request, and members of a banking conglomerate are obliged to provide, all the necessary information that may affect the banking activity of the bank and banking conglomerate. The AFR is also entitled to apply regulatory measures to the banks and to members of the banking conglomerate.

iv Recovery and resolution

Kazakh law provides for both voluntary and compulsory arrangements for the resolution of failed banks.

Voluntary recovery and resolution

Voluntary arrangements are initiated by the bank itself and include voluntary bank restructuring and voluntary transfer of assets and obligations to another bank or banks.

Voluntary bank restructuring

Bank restructuring can be applied where a bank is not able to meet its obligations to any given creditor due to absence, or insufficient amounts, of money. The restructuring is initiated by the bank itself subject to the relevant decision of the Kazakh court and approval of the restructuring plan by the financial regulator and not less than two-thirds of the bank's creditors. The bank restructuring regime applies also to a non-banking parent company of the bank that is a part of the banking conglomerate.³¹ The bank restructuring regime was introduced to the Banking Law as a response to the 2008 financial crisis and has been applied to the largest Kazakh banks (BTA Bank, Alliance Bank and SB Temir Bank) and a non-banking parent company (Astana Finance), which failed to meet their obligations to international creditors.

27 Article 72 of the Prudential Ratios Resolution.

28 Article 80 of the Prudential Ratios Resolution.

29 Article 42 of the Banking Law.

30 Article 2.3 of the Banking Law.

31 Section 6-1 of the Banking Law.

Voluntary transfer of assets and obligations

In the interests of creditors of the bank, Kazakh banks can transfer assets and obligations, in part or in full, to another bank or banks, subject to approval of the financial regulator.³² This transfer is subject to the consent of depositors and creditors of the transferring bank. An absence of written objections from creditors and depositors of the transferring bank is considered as consent for the transfer.³³ Consent of the bank's debtors is not required, unless this is otherwise provided by the relevant agreement between the transferring bank and its debtor.³⁴ The transfer is conducted based on the agreement between the transferring bank and the acquiring banks and on a special document, called the 'act of delivery and acceptance', which lists the transferred assets and liabilities.³⁵ Upon transfer, the obligations to the transferring bank's counterparties are performed by the acquiring bank.³⁶ The acquiring bank is subject to basic requirements that would allow it to perform the transferring bank's obligations to its counterparties.

Compulsory recovery and resolution

The AFR is entitled to recognise the bank as having an unstable financial position that threatens the interests of the bank's depositors and creditors or threatens stability of the financial system, or both, in the following cases:

- a* decrease of capital adequacy ratios below the established minimal level;
- b* non-performance by the bank of its monetary obligations to the creditors due to an absence, or an insufficient amount, of money;
- c* identification by the AFR of certain facts (transactions), of which the proper reflection in the financial or other statements of the bank would lead to either the bank breaching the capital adequacy ratio or non-performance of its monetary obligations to the creditors due to an absence, or insufficient amount, of money; and
- d* identification by the AFR of shortcomings or risks in the bank's activity that may lead to a situation that would threaten the stable functioning of the bank, the interests of its depositors or creditors, and stability of the financial system.³⁷

Once the AFR recognises the bank as having an unstable financial position, the bank is prohibited from paying dividends or performing any financial obligations to its major participants (shareholders with 10 per cent or more of the voting shares) or bank holding companies (shareholders with 25 per cent or more of voting shares), and from paying bonuses to its management.³⁸ The bank must establish a plan to improve its financial position, which must be agreed to by the bank's major participants and bank holding companies, and which must be presented to the AFR for approval. The plan must include the particular measures to

32 Article 61-2.1 of the Banking Law.

33 Article 61-2.4 of the Banking Law.

34 Article 61-2.1.10 of the Banking Law.

35 Article 61-2.11 of the Banking Law.

36 Article 61-2.5 of the Banking Law.

37 Article 61-6.1 of the Banking Law.

38 Article 61-6.3 of the Banking Law.

be taken by the bank and its shareholders to save the bank. The plan must be implemented within 12 months of the AFR approval, with the option of a 12-month extension, provided that an improvement to the bank's financial position occurs during the first 12 months.³⁹

Upon expiry of the above period and if there is no progress, the AFR shall recognise the bank as insolvent and will apply one of the arrangements on compulsory resolution provided by the Banking Law. In certain cases, the AFR can make this recognition earlier.⁴⁰ Compulsory resolution arrangements include compulsory restructuring; compulsory transfer of assets and obligations to another bank or banks; creation of a stabilisation bank and transfer of assets and obligations of the insolvent bank to the stabilisation bank; withdrawal of banking licence; and compulsory liquidation of the insolvent bank.⁴¹ State support is possible in the resolution of an insolvent bank, provided that the bank's liquidation carries systemic risks to the financial system and that the state support would allow effective application of the compulsory arrangements.⁴² In the implementation of compulsory measures, the AFR is entitled to apply a conservation procedure and can appoint a temporary administrator to manage the bank during this time.⁴³ In addition, the court can issue a decision on compulsory reorganisation or rehabilitation of the bank.⁴⁴

Compulsory restructuring

Compulsory restructuring of banks is applied following a decision of the AFR. In compulsory restructuring, the AFR has bail-in powers; namely, it is entitled to require:

- a* mandatory write-down of the insolvent bank's debt in full or in part;
- b* conversion of the insolvent bank's securities and other monetary obligations to shares; and
- c* an amendment to the maturity and interest rates applied to the bank's obligations.⁴⁵

These bail-in powers do not apply to certain types of debt of the insolvent bank, including designated assets provided as security in project finance and securitisation transactions, assets held by the insolvent bank in custody, employee salaries, secured obligations, deposits of individuals not related to the insolvent bank and tax payments.⁴⁶

Compulsory transfer of assets and obligations to another bank or banks

Compulsory transfer in full or in part of an insolvent bank's assets and obligations to another bank or banks is made based on the AFR's decision in the process of conservation of the insolvent bank. A temporary administrator acts on behalf of the insolvent transferring bank.⁴⁷ The obligations of the insolvent bank are transferred to the acquiring bank in the order of priority established for the satisfaction of the creditors' claims in liquidation of the bank.⁴⁸

39 Article 61-6.4 of the Banking Law.

40 Article 61-7 of the Banking Law.

41 Article 61-8.4 of the Banking Law.

42 Article 61-8.5 of the Banking Law.

43 Article 61-9.1 of the Banking Law.

44 Article 74-2 of the Banking Law.

45 Article 61-10.1 of the Banking Law.

46 Articles 61-10.3 and 74-2 of the Banking Law.

47 Article 61.11-1 of the Banking Law.

48 Article 61.11-2 of the Banking Law.

At the end of the transfer, the temporary administrator of the insolvent bank recommends to the AFR that the insolvent transferring bank has its licence withdrawn and undergoes compulsory liquidation.⁴⁹

Transfer of assets and obligations to a stabilisation bank

The temporary administrator of an insolvent bank can suggest that the AFR establishes a stabilisation bank for the transfer of assets and obligations. If the AFR agrees, a stabilisation bank is established for the sole purpose of the transfer.⁵⁰ Upon transfer, performance by the stabilisation bank of the insolvent bank's obligations is postponed for 12 months, whereas matured obligations shall be performed immediately by the stabilisation bank. The stabilisation bank then transfers the assets and obligations to another acquiring bank determined by the AFR. Following the transfer, the stabilisation bank is liquidated. As an alternative, the stabilisation bank can be sold to an investor and may perform regular banking activity, provided that the investor can guarantee proper functioning of the bank.⁵¹

Withdrawal of licence and compulsory liquidation

If the AFR believes that none of the above resolution arrangements would be effective, it can apply to the court for withdrawal of the insolvent bank's banking licence and its subsequent liquidation.

Compulsory reorganisation or rehabilitation

Compulsory reorganisation of the bank can be performed by a special administrator based on a court decision, and is subject to the AFR's approval.⁵² If there is a possibility to reinstate the financial position of the bank, the bank can apply to the court for the introduction of a rehabilitation procedure as part of compulsory reorganisation.⁵³ The rehabilitation procedure shall not take more than six months and shall be performed based on the rehabilitation plan filed by the bank to the court.⁵⁴

Although there is a variety of tools available under Kazakh law for the recovery and resolution of insolvent banks, in practice the AFR tends to use the ultimate measure of banking licence withdrawal and compulsory liquidation. This has been seen in the recent cases of KazInvestBank, Delta Bank, Qazaq Banki, EximBank Kazakhstan, Bank Astana, AsiaCredit Bank and TengriBank.

49 Article 61.11-14 of the Banking Law.

50 Article 61-12.1 of the Banking Law.

51 Articles 61-12.6 to 61.12.8 of the Banking Law.

52 Articles 74-3.1 and 74-3.3 of the Banking Law.

53 Article 74-3.2-1 of the Banking Law.

54 Article 74-3.2-3 of the Banking Law.

IV CONDUCT OF BUSINESS

In Kazakhstan, banking is strictly regulated. Apart from the general prohibition for banks to perform any business activity other than banking activity and the obligation of banks to comply with prudential and other mandatory thresholds, requirements and regulatory norms of the AFR, Kazakh banks are subject to the following local rules that govern the conduct of their business.

i Mandatory deposits guarantee

Kazakh banks with a licence for accepting deposits and opening and maintaining individual accounts must participate in a mandatory deposit guarantee system.⁵⁵ A mandatory guarantee of individuals' deposits is provided by a special non-commercial organisation, the Kazakh Fund of Deposit Guarantee. If a bank loses its banking licence, the Kazakh Fund of Deposit Guarantee guarantees the return to individual customers of the following amounts:

- a up to 15 million tenge, for tenge savings deposits;
- b up to 10 million tenge, for other tenge deposits; and
- c up to 5 million tenge – for deposits in foreign currency.

If there are several deposits from one customer, the total guaranteed amount shall not exceed 15 million tenge.⁵⁶

ii Continuity of banking services and data security

Banks shall provide a guaranteed level of continuity of service to their clients, including by ensuring that their information systems have reserve centres and reserve connection channels to enable their reinstatement. The financial regulator establishes requirements to security and continuity of information systems of banks.⁵⁷ In addition, banks shall have information security management systems that target identification of, and combat, information security incidents. Reports on information security management systems and compliance with informational security requirements must be submitted by the banks to the National Coordination Centre on Informational Security.

iii Currency control

The operations of Kazakh banks and their clients with non-resident counterparties are subject to currency control. Kazakh banks must report the majority of their own, and their clients', transactions to the NBK, which exercises the control and regulation of currency in Kazakhstan.

55 Article 61-1.2 of the Banking Law.

56 Article 18 of Law No. 169-III of the Republic of Kazakhstan, dated 7 July 2006, on mandatory guaranteeing of deposits placed with the second-tier banks of the Republic of Kazakhstan (the Mandatory Deposits Guarantee Law).

57 Article 61-5.1 of the Banking Law.

iv Anti-money laundering

Kazakh banks are deemed as ‘subjects for financial supervision’ and, as such, must report client transactions of a certain type, those that exceed the thresholds established by the Anti-Money Laundering Law (the AML Law),⁵⁸ or those that are deemed suspicious under the AML Law, to the Financial Monitoring Agency, the state body responsible for combating money laundering and terrorist financing. If it is not possible to check transactions as provided for by the AML Law, or if so directed by the Agency or law enforcement bodies, Kazakh banks are entitled to block the suspicious transaction. Kazakh banks shall also perform identification and know-your-customer procedures in relation to their clients in line with AML Law requirements.

v Protection of financial services’ consumers

Kazakh banking law provides fairly strong protection of financial services’ consumers. Thus, *inter alia*, Kazakh banks are obliged:

- a* to conclude bank loan agreements in strict compliance with the AFR’s detailed requirements, including in terms of the order of presentation of the bank loan’s conditions, and the type and size of font used;
- b* an annual effective interest rate, to loans, that cannot exceed 56 per cent and that is calculated based on the formula established by the AFR;⁵⁹
- c* not to unilaterally increase interest rates, except where expressly permitted by the law;⁶⁰
- d* not to unilaterally increase commissions provided for by loan agreements or introduce new commissions not provided for by loan agreements;⁶¹ and
- e* not to charge borrowers for early repayment of loans, except where expressly provided for by the law.⁶²

vi Banking secrecy

Banks are generally required to keep information on their clients and operations confidential (banking secrecy). Banking secrecy includes information: on the availability, owners and numbers of bank accounts; on depositors, customers and correspondents of the bank; relating to the balance and flow of money in these accounts and the accounts of the bank itself; banking operations (except for general terms of the execution of banking operations); and on the availability, owners, character and value of customers’ property kept in the bank’s safe boxes, boards and premises.⁶³ Banking secrecy does not include information on credits issued by banks that are undergoing liquidation. Banking secrecy can generally be disclosed only upon consent of relevant persons or in cases specifically permitted by the law (e.g., to law enforcement bodies upon their request).

58 Law No. 191-IV of the Republic of Kazakhstan, dated 28 August 2009, on combating legalisation (laundering) on income received by criminal way and financing of terrorism (the AML Law).

59 Article 39.7 of the Banking Law.

60 Article 39.6 of the Banking Law.

61 Article 39.2 of the Banking Law.

62 Article 39.5 of the Banking Law.

63 Article 50 of the Banking Law.

vii Personal data regulation

The legal regime of personal data protection is currently developing in Kazakhstan. Generally, any data based on which one can identify a physical person (e.g., name, address and bank account number) shall be considered as personal data. Any action in connection with personal data, such as collection, use, processing and transfer (including cross-border transfer) is, generally, subject to written consent of the individual to whom the personal data belongs. Personal data can be disclosed without consent only in limited cases established by the law. Owners and operators of personal data databases must keep these database in the territory of Kazakhstan. Accordingly, Kazakh banks collect the consent of all their individual customers for the above actions relating to their personal data, and must ensure that the personal data is stored in Kazakhstan in compliance with technical and other requirements of the Committee on Informational Security, the state regulator in the personal data sphere.

viii General laws

In addition to the above, a number of other laws and legal acts apply to banks in the conduct of their business, such as securities market law, advertising law and antitrust law.

For breaches of law and legal acts, banks can bear civil and administrative liability, and their management and employees can bear criminal liability (legal entities are not subject to criminal liability in Kazakhstan). Civil liability can be incurred for the bank for damage caused to its customers as a result of, for example, a breach of banking secrecy or personal data confidentiality, or charging interest above the established level. Administrative liability is most frequently incurred by banks for breaches of legal acts of the AFR and NBK; for example, for non-compliance with prudential ratios and other mandatory norms. Criminal liability of the bank's management can be incurred for driving the bank into insolvency,⁶⁴ the provision of false information on banking operations⁶⁵ and illegal use of the bank's money.⁶⁶

V FUNDING

Kazakh banks fund their activities from typical sources, such as shareholders' contributions, deposits, capital markets (initial public offerings (IPOs) and bonds issuances), loans and repo transactions with other banks, and funding from the NBK (e.g., 'loans of final recourse'). Loans of final recourse are provided by the NBK in tenge for a maximum period of one year to Kazakh banks with a short-term liquidity deficit. These loans must be fully secured by the assets that comply with certain requirements established by the NBK, and cannot be issued to banks with an unstable financial position or insolvent banks.⁶⁷

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

Generally, the following persons can become a shareholder of a Kazakh bank:

- a* an individual (either resident or non-resident of Kazakhstan);

64 Article 239 of the Criminal Code.

65 Article 242 of the Criminal Code.

66 Article 243 of the Criminal Code.

67 Article 51-3 of the Banking Law.

- b* a Kazakh legal entity;
- c* a foreign legal entity provided that the following conditions are met:
- the foreign legal entity is not registered in one of the offshore zones, the list of which is established by the AFR and includes, for example, the British Virgin Islands, Liechtenstein and Macau. If it is revealed that a legal entity from an offshore zone was a shareholder in a Kazakh bank and had voted at the general shareholders' meeting, the results of the vote must be reconsidered. The offshore zone prohibition does not apply to parent non-resident banks of Kazakh banks if the parent bank has the required level of credit rating established by the AFR;⁶⁸
 - if more than 25 per cent of shares are acquired, the foreign legal entity shall be subject to consolidated supervision in its country of establishment; and
 - the foreign legal entity or its parent shall have long term credit rating in a foreign currency not lower than 'BBB' by Standard&Poor's or an analogous level of rating by Moody's or Fitch.

Alternatively, the foreign entity shall meet all of the following conditions: (1) long-term credit rating by international scale in a foreign currency of not lower than 'BB-' by Standard & Poor's or analogous level of rating by Moody's or Fitch; (2) the foreign legal entity shall be a resident of a country with sovereign rating in a foreign currency of not lower than 'BB-' by Standard & Poor's or analogous level of rating by Moody's or Fitch; and (3) there shall be agreement in place between the AFR and financial regulator of the country of establishment of the purchaser foreign legal entity. This agreement shall provide for exchange of information between the two regulators.

As a general rule, acquisitions by a person or a group of persons, directly or indirectly, of 10 per cent or more (major participant status) or 25 per cent or more (bank holding company status) of voting shares in a Kazakh bank are subject to the prior approval of the AFR. The requirement to obtain the AFR's prior approval for the status of major participant or bank holding company does not apply to a legal entity if that legal entity intends to indirectly hold a relevant stake in a Kazakh bank through holding shares in a financial organisation that is already a major participant or bank holding company of the Kazakh bank and, in terms of non-residents, is subject to consolidated supervision in its country of incorporation.⁶⁹

The process of obtaining AFR approval is lengthy and requires provision of a number of documents including a detailed business plan in the case of acquisition of 25 per cent or more of the voting shares⁷⁰ by legal entities and physical persons, and proof of source of funds for the acquired shares in the case of acquisition of 10 per cent or more of the voting shares by physical persons.⁷¹ Any amendments to the amount of held shares is subject to notification to the AFR.⁷²

In addition to AFR approval, prior antitrust approval is required if the acquired stake exceeds 50 per cent of voting shares in a Kazakh bank, provided that the Kazakh bank's assets or own capital exceed the thresholds established by the AFR.⁷³

68 Article 17 of the Banking Law.

69 Article 17-1.2-1 of the Banking Law.

70 Article 17-1.7-1 of the Banking Law.

71 Article 17-1.4 of the Banking Law.

72 Article 17-1.18 of the Banking Law.

73 Article 201.1, 201.5 of the Business Code.

Kazakh banks must notify the AFR of changes in shareholders holding 10 per cent or more of the voting shares.⁷⁴

In structuring the acquisition of the Kazakh bank, foreign acquirers must ensure that they are not in breach of the offshore zone prohibition, have the required level of credit rating and must be ready for the lengthy process of obtaining AFR approval for major participant or bank holding company status and, where applicable, antitrust approval. Generally, target banks can pledge their assets to secure obligations of the acquirer to repay the acquisition finance, provided that this pledge is not considered as business activity (i.e., the target bank will not receive any commission for providing security).

ii Transfers of banking business

Under Kazakh law, generally, a legal entity can accept rights and obligations of a bank under transactions that constitute banking activity, such as bank lending and deposit taking, provided that the legal entity has legal capacity to conduct the relevant types of banking activity based on the banking licence or by the virtue of law.

The Banking Law contains the specific list of the third parties to which rights and obligations under bank loan agreements can be transferred. These third parties include:

- a* other Kazakh banks and banking organisations;
- b* collection agencies;
- c* a special subsidiary of the bank that deals with problem assets of its parent bank;
- d* organisations that specialise in the improvement of Kazakh bank loan portfolios;
- e* special purpose vehicles established for the purpose of securitisation performed under Kazakh law;
- f* NBK's subsidiary that buys out individuals' mortgages; and
- g* special funds for business development.

In addition, Kazakh banks can transfer their assets to the NBK as security for final recourse loans, as discussed in Section V.⁷⁵

Further, as a general rule, Kazakh banks are not entitled to assign rights and obligations under bank loans unless otherwise specifically permitted by a bank loan agreement.⁷⁶ In addition, Kazakh banks must obtain the consent of individual customers for the transfer of their personal data to third parties, including cross-border transfers. In all cases, Kazakh banks must also obtain client consent for the disclosure of banking secrecy matters. As standard practice, for the purposes of, inter alia, the potential transfer of banking business, Kazakh banks include in their customer agreements, broad customer consent that would allow them to assign their rights and obligations under bank loans and other products, transfer personal data and disclose banking secrets to third parties without additional customer consent. Prior to the potential transfer and after the transfer of bank loans, Kazakh banks must notify the borrowers thereof.⁷⁷

The Banking Law details certain cases in which assets and liabilities of Kazakh banks can be transferred to another bank or banks without the consent of customers. These cases

74 Article 17-1.20 of the Banking Law.

75 Article 36-1.4 of the Banking Law.

76 Article 36-1.5 of the Banking Law.

77 Article 36-1.7 of the Banking Law.

include the compulsory transfer of assets and obligations of the insolvent bank⁷⁸ to another bank or banks and the transfer of assets and obligations to or from a stabilisation bank⁷⁹ (see Section III.iv).

In practice, the acquisition of banking business in Kazakhstan is structured as a share transaction rather than an asset transaction.

VII THE YEAR IN REVIEW

i Foreign banks' decreasing share

In 2021, the Kazakhstan financial sector remained dominated by domestic commercial banks. The banking sector is largely domestically owned, private and relatively concentrated, with the largest seven banks accounting for 78 per cent of total banking assets. Western banks such as RBS, HSBC and Unicredit left the market several years ago as, apparently, Kazakhstan is no longer within their field of interest. The only remaining subsidiary of a western bank is Citibank Kazakhstan, 100 per cent owned by the US Citibank NA, which seems to be mostly focused on servicing Citigroup's global clients' activity in Kazakhstan. The recent acquisition of 60 per cent of Altyn Bank by China CITIC Bank Corporation Limited and China Shuangwei Investment Co Ltd confirms the increasing interest of Chinese players in the Kazakh banking sector. Russian major players such as Sberbank, VTB and Alfabank entered the Kazakh financial market a long time ago by establishing their subsidiaries in Kazakhstan, currently having a market share of 15 per cent of total assets of Kazakh banks.⁸⁰ As local currency became even more volatile and Russian parent banks fell under the sanctions imposed by the Western world as a result of the war in Ukraine, Kazakh banks in general and Kazakh subsidiaries of the Russian banks in particular are likely to be affected in the long term, though at the time of writing the AFR reports absence of critical impact of those challenges on banking activity.⁸¹ To help the banks withstand another crisis, the AFR temporarily introduced a special procedure for performing certain prudential ratios. In the event prudential ratios will not be met due to external reasons, such as high volatility of local currency and withdrawal of money by the population, the banks will be given an opportunity to arrange additional volumes of liquidity in order to meet minimal prudential ratios. In addition, until 1 September 2022 deposits and loans received from parent foreign banks of Kazakh banks will not be considered in calculation of 'capital to the bank's obligations to non-residents' ratio.

ii Consolidation of banks

In Kazakhstan, there is currently a trend for consolidation of banks, and the centralisation of financial institutions into the hands of the most powerful elites in Kazakhstan continues, which has resulted in increasing numbers of mergers and acquisitions in the banking sector. This trend is explained by various factors, including the inability of Kazakh

78 Article 61-11.5 of the Banking Law.

79 Article 61-12.6 of the Banking Law.

80 <https://informburo.kz/novosti/kakuyu-dolyu-na-rynke-kazaxstana-zanimayut-docki-rossiiskix-bankov>.

81 https://forbes.kz//finances/finance/kakoe_vliyanie_na_kazahstanskije_banki_okazyvayut_antirossiyskie_sanktsii_rasskazali_v_arrfr/.

banks and their controlling shareholders to provide additional capital and meet other prudential requirements and expected competition from foreign banks due to Kazakhstan joining the World Trade Organization (WTO).

In 2018, Halyk Bank, the largest Kazakh bank, acquired Kazkommertsbank, the second-largest Kazakh bank. Halyk Bank also sold 60 per cent of its subsidiary, Altyn Bank, to Chinese investors China CITIC Bank Corporation Limited and China Shuangwei Investment Co Ltd.

In 2019, First Heartland Securities acquired 99.8 per cent of Tsesnabank, which was close to a default situation. After recapitalisation by the new controlling shareholder, Tsesnabank has merged with First Heartland Bank, another Kazakh bank. The surviving bank is called First Heartland Jýsan Bank. In December 2020 and February 2021, First Heartland Jýsan Bank acquired a 100 per cent stake in ATF Bank and is now considering its accession, so that there will soon be one less player in the banking market.

In May 2019, Forte Bank acquired a 100 per cent in another Kazakh bank, Bank Kassa Nova. In December 2020, Forte Bank sold this 100 per cent stake to Freedom Finance, a company that specialises in brokerage, underwriting, investment banks business and consulting services in securities market. The acquired bank was renamed and is now operating under the name Bank Freedom Finance Kazakhstan.

In September 2021, First Heartland Jýsan Bank acquired JSC ATF Bank and became third largest bank by capital and assets in Kazakhstan.⁸²

It is expected that not all Kazakh banks can stand the challenging environment of volatile local currency and confrontation of Russia and the West. As a result, consolidation in the banking sector will continue, and there will be a number of further mergers and acquisitions of small and medium-sized banks. Investments are expected not only from local, but also from international, investors. According to public sources, the European Bank for Reconstruction and Development is monitoring the Kazakh market for equity investment opportunities in the banking sector.

iii Liquidation of defaulting banks

Due to the above-mentioned shortage of capital of certain banks and the inability of their shareholders to provide additional capitalisation, in conjunction with inadequate risk management and the provision of unsecured loans to related parties, some small and medium-sized banks in Kazakhstan have recently been deprived of their banking licences by the regulator. The regulator withdrew the banking licences of KazInvestBank in 2016, Delta Bank in 2017, Qazaq Banki, EximBank Kazakhstan and Bank Astana in 2018, AsiaCredit Bank and TengriBank in 2020, and CapitalBank Kazakhstan in 2021.⁸³ These banks are now in the process of compulsory liquidation. It is expected that the 'cleaning-up' of the banking sector will continue for the reasons mentioned above, which may eventually help market stabilisation.

82 https://forbes.kz/finances/finance/jusan_bank_poglotil_atfbank/.

83 https://forbes.kz/finances/finance/esche_odin_bank_lishili_litsenzii_v_kazahstane/.

iv Tightening of regulation

Banking regulation in Kazakhstan has always been conservative, and the regulator has historically had fairly broad powers in its supervision, although this has not always been effective, as illustrated by the licence withdrawals mentioned above. The push for further tightening of banking regulation is demonstrated by, for example, the steps already taken to introduce Basel III and the motivated judgement concept that basically allows the regulator to decide on critical issues of banks at its own discretion. In its efforts to improve regulation, in 2019 the NBK initiated an asset quality review (AQR) programme to identify key risks applicable to customers of Kazakh banks and ways in which to address them. One of the recommendations, following the completion of the AQR in January 2020, was additional capitalisation of Kazakh banks by their shareholders with their own funds, this time without the involvement of budget funds, as has regularly occurred throughout the past 10 years as a consequence of the financial crisis. From 2021, AQR and supervisory stress testing will be regularly conducted as part of the AFR's supervisory process. Notwithstanding the overall trend for an increase in regulation, in 2020 and 2021, due to the covid-19 crisis and war in Ukraine, the regulator had to temporarily release some of the prudential requirements on Kazakh banks related to their capitalisation and liquidity. These measures are expected to be abolished as the situation improves.

In their efforts to further enhance the stability of the financial market and to make regulation more efficient, the AFR and the NBK are to adopt the 'Concept of Financial Sector Development for 2030' at some point in 2022. This will determine new priorities and strategic directions for the financial sector's development. The aim is to establish a competitive high-technology financial sector that would facilitate financial stability and support sustainable and inclusive economic development.

v New players – branches of foreign banks

As one of the conditions for Kazakhstan joining the WTO, Kazakhstan accepted the obligation of allowing branches of foreign banks, insurance and reinsurance organisations and insurance brokers to perform business in Kazakhstan, which was previously prohibited. Before 16 December 2020, foreign banks could open representative offices in Kazakhstan, which could only be used for marketing and analytical purposes and were not allowed to perform any business activity. Since 16 December 2020, foreign banks have been able to open branches that may perform banking business based on the licence issued by the AFR and subject to certain other conditions.

To open a branch in Kazakhstan, a foreign bank shall obtain relevant permission and a banking licence from the AFR and shall register its branch with the state corporation Government for Citizens, an entity responsible for the registration of legal entities in Kazakhstan. Branches of foreign banks will be allowed to perform regular banking operations, including all types of lending and accepting deposits from individuals for a minimum amount of US\$120,000. Foreign banks that intend to open a branch in Kazakhstan must have a high credit rating and total assets of not less than US\$20 billion, and must place a reserve amount of not less than 10 billion tenge in the NBK account as a guarantee of its branch's financial stability. Foreign banks must also obtain permission from the AFR for appointment of management, and at least two persons in the management team must be Kazakh residents. Other requirements also apply. Branches of foreign banks are subject to

the same requirements as Kazakh local banks, including the requirement to comply with prudential ratios and other norms established by the financial regulators. Foreign banks will be able to open branches in Kazakhstan by submitting a single, simplified application.

Novelties to the Kazakh law that allow foreign banks to open branches in Kazakhstan have been expected to attract new foreign players to the Kazakh banking market, improve competition and facilitate the development of the Kazakh financial sector and the Kazakh economy as a whole. However, no branches of foreign banks have yet been registered in Kazakhstan. Given the AFR's tough requirements on foreign banks and their branches and the fact that foreign banks can still perform their business in Kazakhstan through local subsidiaries or on a cross-border basis, these banks may not have much appetite for this new opportunity of performing banking business in Kazakhstan.

vi Islamic banking on the rise

Islamic banking is currently the fastest-growing segment of the financial sector in Kazakhstan. As at 1 August 2021, the total assets of the only two Islamic banks in Kazakhstan had reached 87 billion tenge, while a year earlier this was 72.1 billion tenge. Average growth of Islamic banks' assets for the past three years comprised 30.3 per cent as compared with 11–12 per cent growth of conventional banks' assets for the same period.⁸⁴ In 2021, the first Islamic fintech startup Tayyab launched the first digital Islamic card, together with Visa and Kazakh RBK Bank.⁸⁵

vii Decline of non-banking online lenders

The Kazakh financial regulator is actively tightening the regulations not only in relation to the banks, but also to other subjects within the financial sector. Previously, in Kazakhstan there was a segment of non-banking companies that issued loans to individuals for a high margin. These companies were mostly fintech companies that provided online loans. They operated in a grey area as, although they provided similar services to banks, they were not regulated, unlike banks and MFOs. The situation changed dramatically in 2020 when a law amendment stipulated that only banks, MFOs, pawnshops and credit partnerships are allowed to issue loans. By 1 July 2020, all companies issuing online loans should have undergone reregistration as MFOs or pawnshops or should have been liquidated. Those that reregistered as MFOs or pawnshops are now subject to relevant regulation by the AFR, including in terms of the prudential requirements, limitation of annual average effective rate, and reporting and disclosure requirements.

viii MFOs booming

Unlike Kazakh banks, Kazakh MFOs are developing quickly. Some of these are bigger than small or medium-sized Kazakh banks in terms of assets and profit, and constitute real competition to Kazakh banks' lending business. Some MFOs are even considering the possibility of converting to banks. Like the Kazakh banks, MFOs are subject to regulatory requirements that are gradually being tightened by the regulator. For instance, since 1 January 2021, the activity of MFOs is subject to a licence from the AFR. However, regulatory requirements for

84 <https://kz.kursiv.media/2021-09-24/pochemu-sektor-islamskikh-finansov-nedostatoch-no-razvit-v-kazahstane/>.

85 https://forbes.kz/finances/finance/pervaya-tsifrovaya-islamskaya-karta-tayyab-zapuschena_v_kazahstane/.

MFOs are, generally, smoother than those applicable to Kazakh banks. This is, probably, the reason why major Kazakh MFOs prefer to remain as MFOs rather than convert to banks, although banking business evidently provides wider business opportunities.

ix AIFC

To encourage international investors into Kazakhstan, the AIFC, a financial hub in Nur-Sultan, the capital of Kazakhstan, was officially launched on 5 July 2018. The AIFC is a special legal regime in the financial sphere with certain tax and other preferences for its participants. Regulation of banking services in the AIFC is carried out by the AFSA and is different from the regulation of banking services in the rest of Kazakhstan, which is provided by the AFR and the NBK. The establishment of two different legal systems in one country poses some interesting questions from a regulatory perspective.

For instance, if a bank is established in the AIFC and holds a banking licence issued by the AFSA, it is not clear whether this bank can provide banking services only within the territory of the AIFC or can also do so in the rest of Kazakhstan without the requirement of an additional licence issued by the main regulator (the AFR). The AFSA and the AFR (together with the NBK) seemed to take different views on the issue. In accordance with the prevailing provisions of the AIFC legislation, neither an NBK nor AFR licence or registration is required for a financial organisation to render financial services, if (1) the financial organisation has a relevant licence issued by the AFSA, and (2) if it conducts its activities only in the territory of the AIFC. The AFSA interpreted the statutory provision such that the financial organisations that are licensed by the AFSA to provide financial services are entitled to provide financial services remotely to clients located in the rest of Kazakhstan (i.e., outside the territory of AIFC) without an additional licence from the NBK or the AFR (i.e., that financial services that are provided remotely to clients who are not in the area of the AIFC equate with the activities in the AIFC). The AFR and the NBK, however, believed that financial organisations with an AFSA licence only are not entitled to provide financial services, even remotely, without an appropriate licence issued by the AFR or registration with the NBK, as appropriate.

In November 2021, the regulators seemed to reach an agreement on these issues. They adopted the Rules No. 6 on currency regulation and provision of information on currency transactions in the AIFC. Apart from currency regulation, these rules established financial services that are allowed or prohibited in the rest of Kazakhstan for financial institutions that are licensed with the AIFC. From our view, these rules limit a range of services that the AIFC-registered financial institutions can provide to its clients as opposed to Kazakh financial institutions registered outside the AIFC. For example, AIFC-registered banks are generally prohibited from opening accounts in local currency to residents (including AIFC participants) and non-residents, carrying out import and export related transactions and carrying out local currency exchange transactions. Further, AIFC-registered banks can only provide the following services to non-AIFC participants: issuing loans to legal entities of Kazakhstan that are not AIFC participants (and, presumably, loans to individuals are prohibited), opening and maintaining current bank accounts for clients (for lending and

investment banking services only) and receiving and making payments or money transfers using current bank accounts (within the permitted types of services).⁸⁶ Any other banking services can be provided by AIFC-registered banks to AIFC participants only.

During its establishment in 2018, the AIFC announced its plan to become a fintech hub for the central Asian region.⁸⁷ For this purpose, inter alia, FinTech Lab, a regulatory sandbox for fintech companies, was established in the AIFC. FinTech Lab is a live environment where fintech companies can offer their innovative services without the full burden of regulatory requirements. As at beginning of 2022, there are 39 FinTech Lab participants registered within AIFC.⁸⁸ The AIFC regulatory framework includes other new areas for Kazakhstan, such as crowdfunding and cryptocurrency. In 2021, cryptocurrency stock exchange Xignal obtained a licence in the AIFC, so development in this sphere is expected in the very near future.⁸⁹

x Digitalisation of the banking sector

Digitalisation of the banking sector has recently been a hot topic in Kazakhstan. Kazakh banks realised that one of the vital components of successful competition for clients in the current environment is not only quick and efficient access to banking services, but also collaboration with other goods and services providers, such as online trading platforms, telecommunication operators and payment organisations. Deferred payments by instalments for retail goods, payments for goods and services from mobiles, and online transfers of money between individuals and similar services provided by banks in synergy with their non-banking partners are becoming more and more popular in Kazakhstan. The covid-19 outbreak and lockdowns boosted digitalisation substantially. As customers could not attend physical bank branches, banks had to completely switch to online services and update their systems accordingly.

Kazakh state bodies treat digitalisation as a key strategic direction of the country's development. In 2017, the government of Kazakhstan adopted the state programme, Digital Kazakhstan, aimed at digitalisation of the economy, including the financial sector. According to the Digital Kazakhstan programme, the financial regulator and other relevant state bodies will cooperate closely to ensure the:

- a* integration of banks' information systems with the information systems of state bodies, such as the tax authorities;
- b* introduction of a remote identification system based on biometric identification;
- c* introduction of regulation of an open application programming interface in the financial sector;
- d* development of non-cash payments;
- e* modernisation of the interbank payment system that supports real-time payments; and
- f* introduction of mobile payments.⁹⁰

86 https://aifc.kz/files/legals/417/file/aifc-rules-on-currency-regulation_eng_2-with-logo.pdf.

87 www.aifc.kz/financial-technologies/.

88 <https://publicreg.myafsa.com/fintech/>.

89 https://forbes.kz/finances/exchange/v_kazahstane_sostoyalos_ofitsialnoe_otkryitie_kriptobirji_xignal/.

90 <https://digitalkz.kz/wp-content/uploads/2020/03/%D0%9F%D0%BB%D0%B0%D0%BD-%D0%BC%D0%B5%D1%80%D0%BE%D0%BF%D1%80%D0%B8%D1%8F%D1%82%D0%B8%D0%B8%CC%86-%D0%A6%D0%9A-%D1%80%D1%83%D1%81.pdf>.

The NBK and the AFR are working closely to implement the programme. Thus, on 1 October 2020, a remote identification system was launched in Kazakhstan by the NBK. The system allows financial market participants to remotely identify clients and remotely open bank accounts, make deposits and issue loans and payment cards. The system is operated by a subsidiary of the NBK and is available for banks, insurance organisations, MFOs, payment organisations and professional participants in the securities market. On 1 January 2021, the AFR introduced new requirements for the assessment of information security by the banks and banking organisations. New rules are aimed at improving information security as well as the ability of banks to deal with the threat of cyber incidents.

xi Fintech

Fintech companies are expected to develop further in Kazakhstan in line with the global trend of fintech competition with traditional banking business. According to the AIFC report,⁹¹ in Kazakhstan there is a substantial element of the rural population that do not have access to banking services because of remoteness and poor infrastructure in rural areas. At the same time, the level of internet penetration is quite high. This seems to be one of the key drivers for fintech development in the country. The general demand for quick and effective online financial services has led to the evolution of fintech companies, mainly in the payments, money transfer and microlending spheres. A prime example of a successful fintech company in Kazakhstan is *kaspi.kz*, which raised US\$1 billion through an IPO in London and locally in 2020. In 2021, Kazakhstan was included in *The Global Fintech Index 2021* at 13th place among Asia-Pacific countries.

The regulators have stimulated the fintech sector by, *inter alia*, the introduction of regulatory sandboxes by the NBK and by the AFSA in the AIFC. Regulatory sandboxes have been developed especially for fintech companies to enable them and the regulators to test financial services provided with the use of high technologies, to help identify possible risks and regulation gaps. Services of fintech companies registered in regulatory sandboxes are provided to real consumers, and all transactions are real and conducted under the thorough supervision of the regulators.

xii Payment systems

International payment systems also play an important role in the digitalisation of the Kazakh banking sector by offering high-technology products to the Kazakh banks. Mastercard and Visa currently dominate the market, and Chinese payment systems are now actively entering the market. The NBK tried to keep pace in 2021 by implementing the following pilot projects: (1) its own instant payments system⁹² as part of the implementation of the recently adopted ‘Concept for Development of Financial Technologies and Innovations for 2020–2025’; and (2) the ‘digital *tenge*’ pilot project implemented with the participation of Kazakh banks.⁹³

91 <https://iclg.com/practice-areas/fintech-laws-and-regulations/2-the-state-of-fintech-in-central-asia-how-kazakhstan-drives-the-regional-fintech-industry>.

92 https://forbes.kz/finances/finance/v_kazhstane_zapustili_edinuyu_platejnuyu_sistemu_zachem_ona_nujna/.

93 https://forbes.kz/finances/finance/dengi_vtsifre_1639577421/.

VIII OUTLOOK AND CONCLUSIONS

The armed unrest in Kazakhstan in January 2022 was an unexpected for Kazakh population, and war in Ukraine shocked the world. In 2022, the government of Kazakhstan is expected to struggle to cope with inevitable impact on Kazakhstan's economy of these events including unprecedented sanctions introduced by the West against Russia, with which Kazakhstan historically has close economic and political connections. Kazakhstan's population has already seen some consequences of this war, and this is only beginning. Local currency dropped in February 2022 by around 20 per cent despite the Kazakh government's currency injections in an attempt to stabilise it. Kazakh subsidiaries of Russian banks seem to be not dramatically affected at the time of writing; however, the withdrawal of funds by people and problems with card payments by their clients in the territory of Russia have been reported. Kazakh importers already faced the problem with the import of goods to Kazakhstan, a large portion of which has been arranged through Russia or from Russian suppliers. It is expected that Russian companies will stop financing in Kazakhstan as they need funds for their internal needs, and some financial sector companies may even leave the country. Western investors may also be unwilling to invest in Kazakhstan as a country associated with Russia. To fight these growing challenges, the Kazakh government together with the National Bank adopted the plan that includes stimulus measures for people to keep money in local currency such as, for example, payment of a premium on local currency deposits to the population and continuous measures for (1) support of Kazakh conventional banks channelling funds to the people; and (2) the decrease of inflation. Kazakhstan also still plans to continue to develop the local capital market and the Islamic finance industry, including through the AIFC, to create alternative sources of financing for SMEs and state and municipal infrastructure projects. On the other hand, oil prices are on the rise, and Kazakhstan sees a lot of interest in relocation on the part of Russian businesses that in the long run may boost the economy and improve the market with increased competition.

According to the AFR, the impact of sanctions on Kazakh banks is limited because Kazakh banks have generally maintained sufficient capitalisation. This was illustrated by the banks' regular reports to the AFR on their compliance with prudential requirements and the results of the AQR research conducted in 2019. Governmental support measures, such as the release of capital requirements, the introduction of state lending programmes and the development of loan guarantee mechanisms, made it possible for Kazakh banks to increase lending volume from the previous year. However, the recent withdrawal of banking licences from several Kazakh banks demonstrates gaps in the banking regulation. In particular, some of the defaulted banks failed to properly assess their credit risks for various reasons, including poor corporate governance and insufficient levels of information transparency. The regulators will focus on improvement in these areas, including by using the motivated judgement tool recently introduced into Kazakh law (see Section III.i). Banking regulation is expected to stay at the same level or even relax in the short term to help the banks cope with ongoing challenges resulting from military actions in Ukraine, although it may become more stringent in the future, with the AFR potentially monitoring banks' performance in relation to the measures identified in the AQR and stress testing programmes, continuing implementation of the Basel III standards and amending the legal and regulatory framework based on the results of

AQR assessments. According to the AFR, the assessments may result in the introduction of additional individual supervisory prudential requirements established by the AFR for each bank depending on its risk profile.⁹⁴

The division of the financial regulator in 2020 into the NBK and the AFR, and the establishment of the AIFC with its own legal regime and financial regulator (the AFSA) in 2018, will require further implementation in the future, with a unified approach to be adopted in a number of areas. There are currently three financial regulators in Kazakhstan, and notwithstanding continuous efforts to make two legal systems compliant with each other, their approaches and regulatory tools still differ, especially those of the AFSA, which generally has a more liberal attitude compared with the conservative NBK and AFR.

Apart from overcoming consequences of military actions taken by Russia, the biggest challenge for the regulators in the near future, in our view, lies in the digitalisation and cybersecurity sphere. Current issues include an absence of qualified specialists in the high technology area used for the provision of financial services, an outdated legal and regulatory framework and an absence of clear coordination among the regulators, with their potentially different approaches.⁹⁵ The regulators would have to develop adequate regulation of fintech companies and financial services so that key risks for consumers, including cybersecurity, are adequately addressed while the sector is not decimated by excessive supervision.

94 www.kapital.kz/finance/91884/oleg-smolyakov-o-bankovskom-sektore-stress-testakh-i-nadzore.html.

95 Joint resolution of the NBK and the AFR No. 69/89, dated 20 July 2020, on approval of cybersecurity strategy in the Republic of Kazakhstan for 2020–2022.

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