

REGULATORY AND SUPERVISORY FRAMEWORK DEVELOPMENT AND MAIN CHALLENGES FOR ISLAMIC FINANCE IN KAZAKHSTAN



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Macroeconomic environment of Kazakhstan

Key economic indicators

Income level	Upper middle
GDP per capita	\$7.5k
GDP growth rate	1%
Inflation rate	7.7%
Interest rate	10.25%
Population	18 Mln.
Unemployment rate	4.9%
Gov't debt to GDP	21.1%

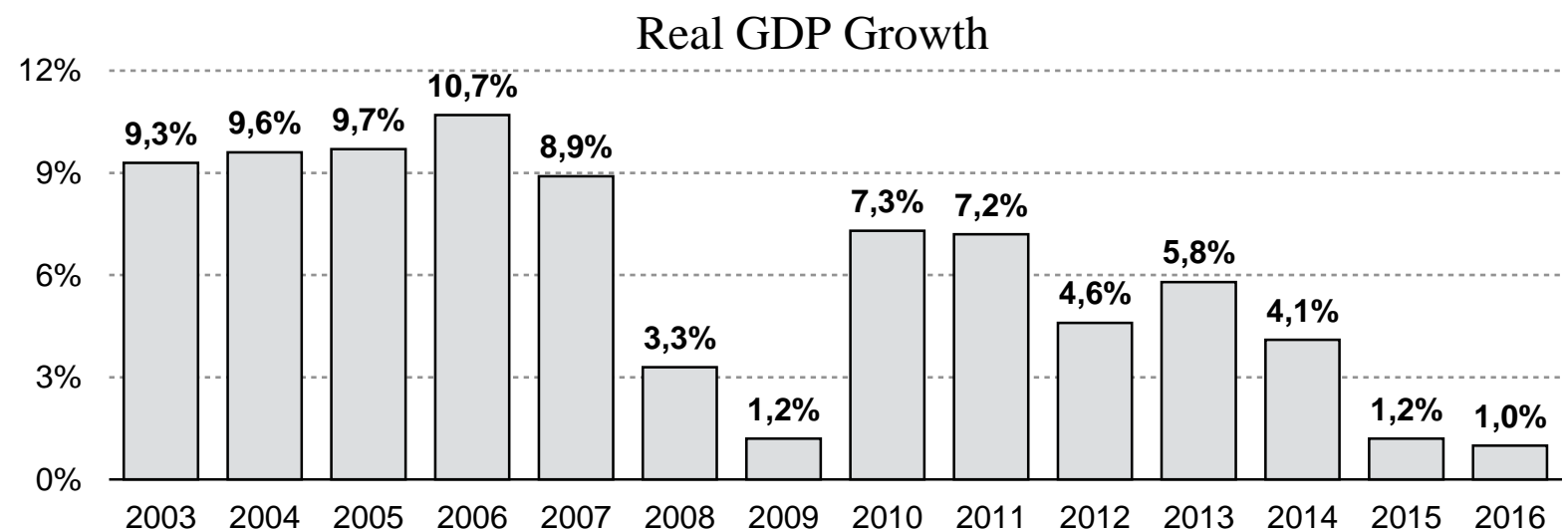
Sovereign credit rating

	Rating	Outlook
Moody's	Baa3	Stable
Fitch	BBB	Stable
S&P	BBB-	Stable

Oil and gas sector has been crucial in achieving high economic growth and increasing country's welfare. However, with the fall of oil prices on the global markets, the economy has undergone a big pressure resulting in large depreciation of the currency and decrease in sovereign funds.

In 2016 agriculture accounts for about 5.5% of GDP, but it employs about 18% of the labor force, which is crucial in addressing poverty.

The official share of the Kazakhstan population living in poverty went down from 47% in 2001 to about 2-3% in 2016.



- Post 2008, the annual average GDP growth rate was around 4%.
- Oil and gas added value in 2016 was \$22.9 bln or 16.7% of GDP.
- Health of financial sector, lower oil production, and weaker external demand are the main downside risks.

As a part of “Kazakhstan – 2050” strategic plan on joining top-30 world economies, government has implemented a number of reforms to improve the business environment

Substantial improvement in creating favourable business environment was reached due to:

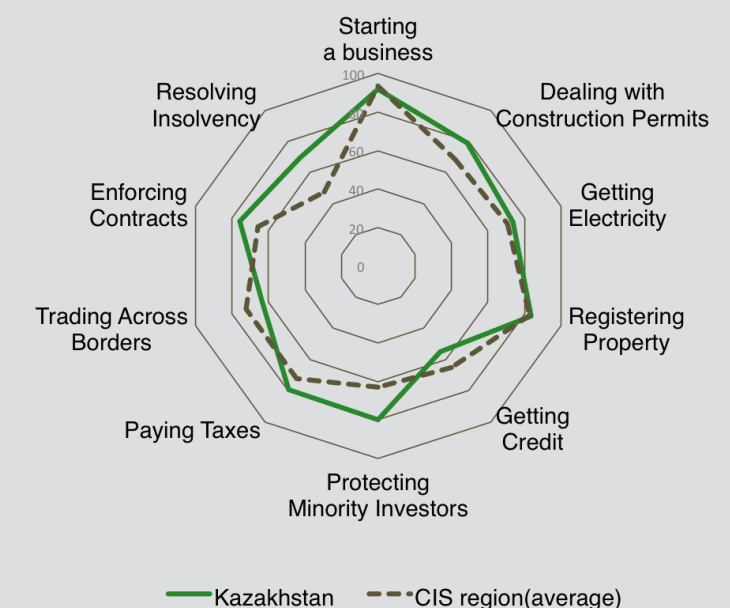
- **Starting a business** became easier by eliminating registration fees for SME, shortening registration time and eliminating some legal requirements.
- **Dealing with construction permits** became easier by introducing a “one-stop shop” system and streamlining procedures.
- **Registering property** became easier with elimination of requirements to obtain technical passport for the transfer and to have the notarised incorporation documents.
- **Protecting minority investors** indicator improved sufficiently from 25th to 3rd ranking due to increase in transparency requirements in financial statement and related transactions.
- Due to establishment of “ICBC “Khorgos” at the border with China, **Trading across borders** indicator greatly increased DTF score from up 8 to 60.
- With adoption of the law of the Republic of Kazakhstan “On Rehabilitation and Bankruptcy” dated 26 March 2014, **Resolving insolvency** indicator increased by 21 point.
- **Enforcing contracts** indicator improved due to introduction of electronic filing system for court users and adoption of amendments to the legislation, and reached 9th rank in DB2017.

DOING BUSINESS IN KAZAKHSTAN

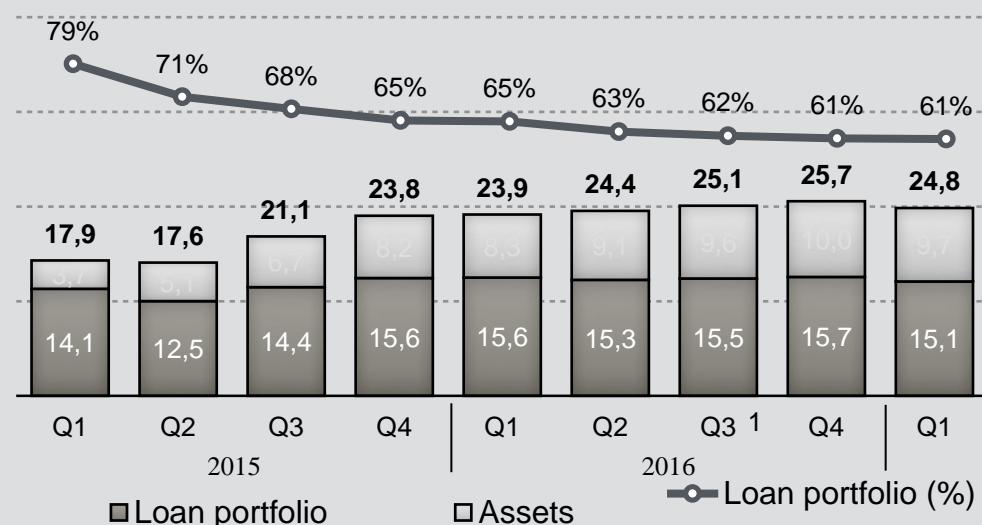
Kazakhstan is ranked 35th in the latest Doing Business rating (by World Bank). Among non-high income countries, Kazakhstan is ranked 4th.

2016	75,1	#35
2015	70,5	#51
2014	68,9	#55
2013	63,4	#84

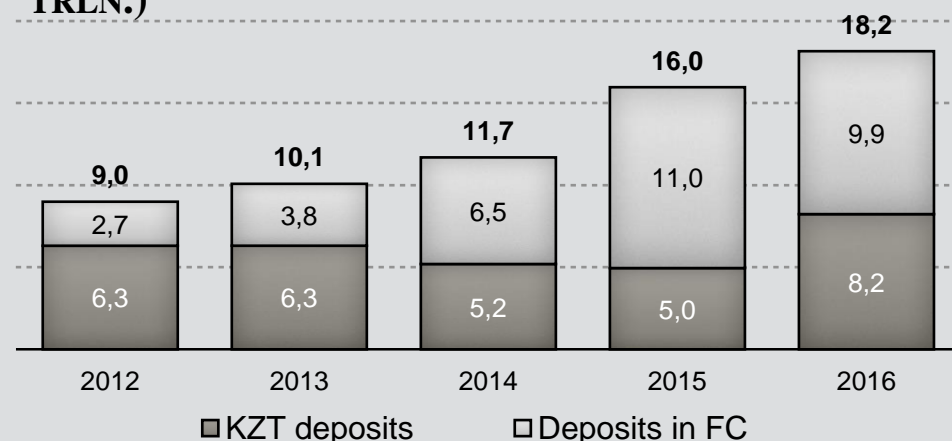
In comparison with average regional performance, Kazakhstan has lower score only in Getting Credit and Trading Across Borders indicators.



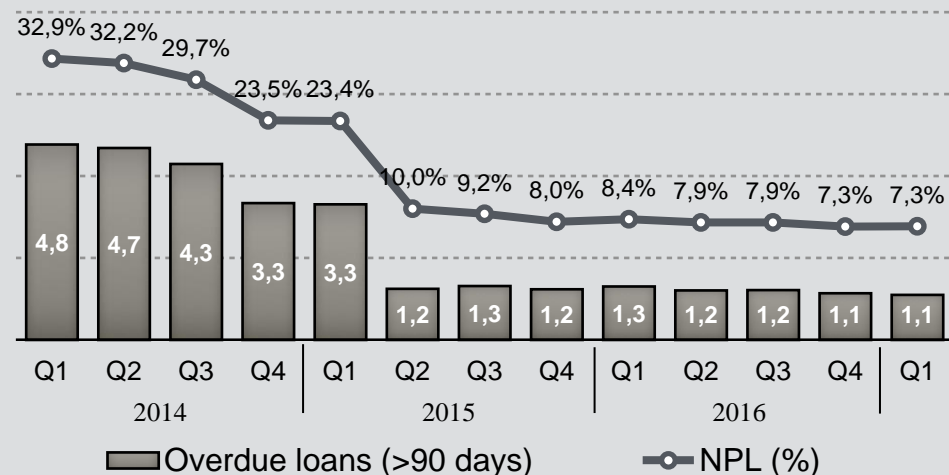
BANKING ASSETS (KZT TRLN.)



TOTAL DEPOSITS (KZT TRLN.)



NON-PERFORMING LOANS (KZT TRLN.)



As of March 2017, Kazakhstan's banking sector is represented by 33 banks, of which 15 banks with foreign participation.

In 2016 total amount of banking assets has increased for \$5.1 bln. (1.8 trln. Tenge) and amounted to \$76.4 bln. (25.6 trln. Tenge). Sharp asset increase after Q2 2015 is primarily due to introduction of free-float regime in Aug 2015 as the main source of financing is the deposits, of which about 70% were in foreign currency in 2015.

Lending to the economy is stagnating, total amount of Loan portfolio is around \$46.9 bln (15.7 trln. Tenge). In 2016 the loans-to-assets ratio decreased from 86% to 60% from the beginning of 2013 primarily due to currency depreciation.

The share of Non-performing Loans is decreasing and is around 7.3% — rapid decline from 32.9% in Q1 2014 (highest since 2009).

However, the banking sector is somewhat fragile due to legacy problems. Legal and tax changes are still required to improve the insolvency regime, remove obstacles to transfers of collateralised debt to the Problem Loan Fund and SPVs, introduce tax incentives for debt write-offs and sales of collateral at below face value.

To minimise the systemic risk, the central bank is in the process of changing its current supervision methodology to risk-based approach and implementing industry-wide stress tests.



ASTANA INTERNATIONAL FINANCIAL CENTRE

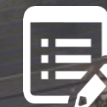
New destination for Islamic finance, asset managers, investment and commercial banks, funds, alternative finance and fintech firms



**COMMON LAW
FRAMEWORK**



**PREFERENTIAL TAX
REGIME FOR 50 YEARS**



**ONE-STOP SHOP
FOR REGISTRATION**



**INDEPENDENT
REGULATION**



**FREE-OF-LEASE
OFFICES FOR 2 YEARS**



**SIMPLIFIED VISA
REGIME**

“ I signed a decree on the establishment of the Astana International Financial Centre. It will be based on the principles of English law, the preferential tax regime and an independent financial court. ”

Nursultan Nazarbayev
President of the Republic of Kazakhstan



Establishment of the AIFC is a part of the “100 Concrete Steps” Presidential initiative aimed at delivering Five institutional reforms.

MAY
2015



The Decree of the President of the Republic of Kazakhstan No.24 “On the Astana International Financial Centre“ dated 19 May 2015 to establish the AIFC in the Astana Expo-2017 International Specialized Exhibition territory.

DEC
2015



The Constitutional Law of the Republic of Kazakhstan dated December 7, 2015 “On the Astana International Financial Centre” will be implemented taking into account the following Decrees of the President of the Republic of Kazakhstan:

- On Enactment of the Management Council of Astana International Financial Centre and the Council’s structure,
- On Defining the Borders of the Territory of Astana International Financial Centre.

2016-
2017



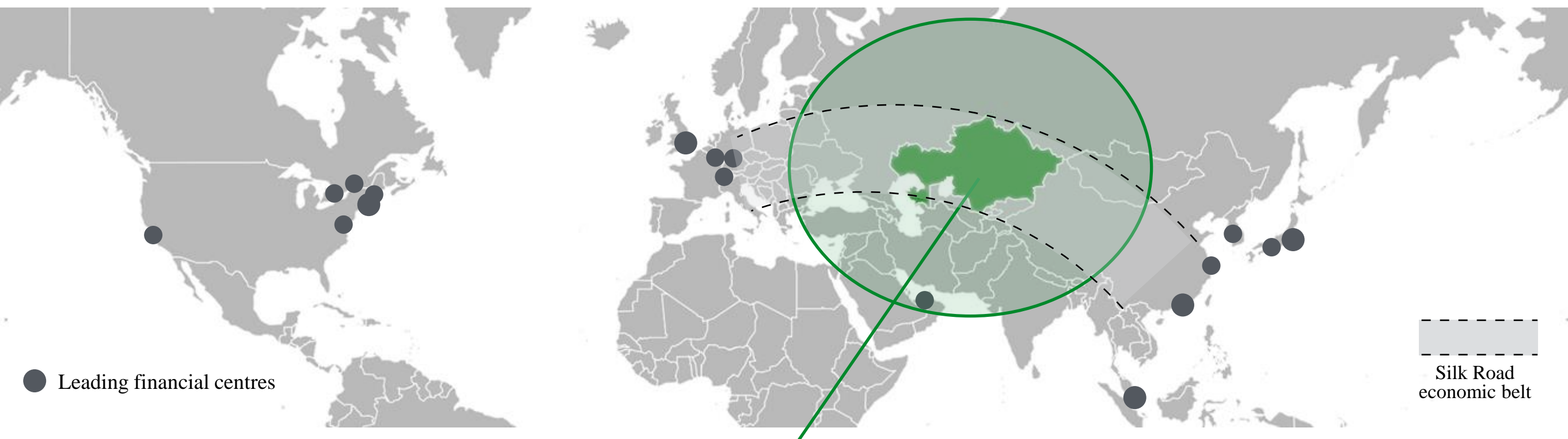
Organizational support is provided by AIFC Authority JSC that was established on December 28, 2015. AIFC Management Council determined the AIFC Development Strategy on May 26, 2016.

JAN
2018



Astana International Financial Centre will be fully functional from January 1, 2018.

To become a financial hub for Central Asia, Eurasian Economic Union, the Caucasus, West China, Mongolia, and Eastern Europe



GOVERNMENT FUNDS

KAZAKHSTAN	in bln.
National Fund	\$64.4
FX reserves	\$30.8
Pension Fund	\$19.4

Total government funds are \$114.6 billion as at Q3 2016.

PRIVATISATION OF STATE-OWNED ENTERPRISES

Samruk-Kazyna SWF will conduct IPO of national companies, incl.:

- petroleum company;
- power generation corporation;
- railway operator, air carrier;
- mining companies, etc.



PRIVATIZATION PROGRAM 2018-2020

GATEWAY TO EURASIAN ECONOMIC UNION (EAEU)

The region has some of the largest reserves of natural resources:

- Top producer of oil and gas (>15%),
- Top producer of uranium (>40%),
- Top 5 producer of electrical energy and coal.

EAEU is also top 5 producer of some agricultural products: wheat, sugar beet, grains, meat products, etc.

DELIVERY UNIT FOR ONE BELT ONE ROAD INFRASTRUCTURE FINANCING OFFICE

The initiative to attract infrastructure investments, incl. investments from:

- Asian Infrastructure Investment Bank (with \$100 bln. capital),
- Silk Road Fund (\$40 bln. capital),
- banks and dev't institutions.

Recreation of legendary Silk Road shall increase business activity in the region as well.

Core pillars of AIFC development

Positioning Astana as a main financial centre in the region shall be achieved through the implementation of the following five core pillars:



CAPITAL MARKET

Increasing local Capital Markets liquidity to attract more foreign investments



ASSET MANAGEMENT

Asset management of private and state funds by localised international asset management companies



PRIVATE BANKING

Developing Private Banking expertise on the basis of localised international asset management companies



ISLAMIC FINANCE

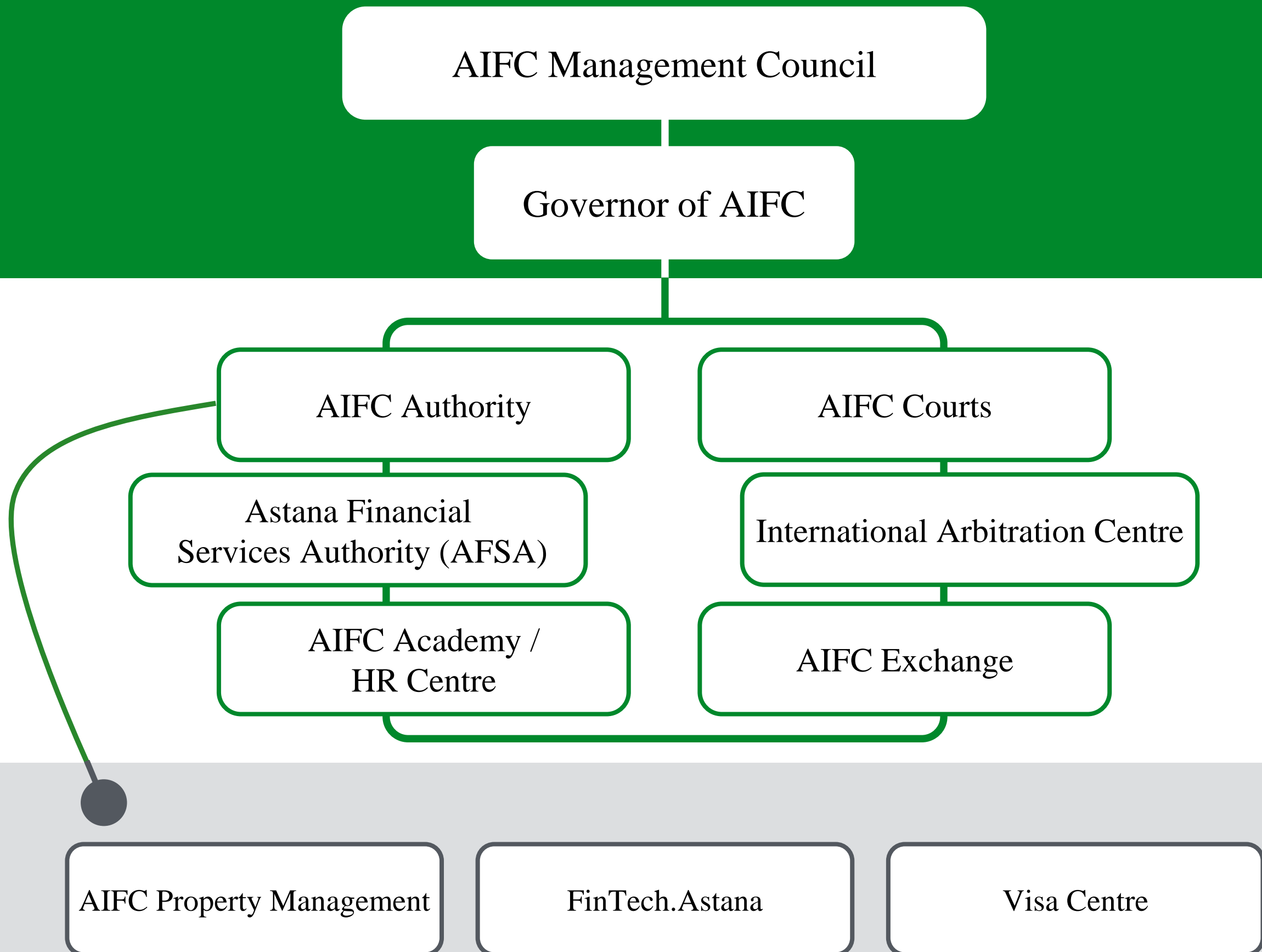
Creating local Islamic Finance market supported by conventional local and international Islamic banks



FINANCIAL TECHNOLOGY

The introduction and development of Financial Technology to remove existing frictions and decrease costs

Organisational structure of AIFC



Islamic finance at AIFC

BEST LEGAL SYSTEM

AIFC establishes a special jurisdiction with independent commercial and civil regulation based on English common law. The system will be institutionalized by the AIFC Courts with qualified judges with previous experience in English common law jurisdiction countries. Out-of-court disputes will be settled by the Astana International Arbitration Centre.

INDEPENDENT REGULATION

An independent regulatory regime will be consistent with recognised international standards to ensure fairness, transparency and efficiency of the financial market, to protect interests of investors and financial services customers, and to minimize systemic risk.

COMPREHENSIVE INFRASTRUCTURE

AIFC as an Islamic finance hub for the CIS and Central Asia will be attractive for Islamic financial institutions.

ACCESS TO PROJECTS IN THE REGION

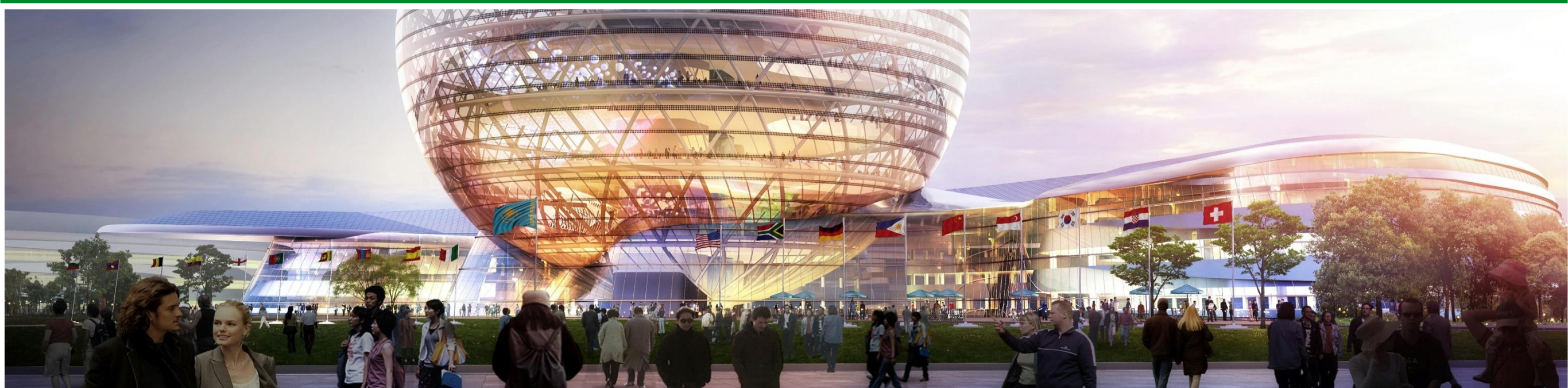
AIFC is located in the heart of Eurasia which provides a unique opportunity to access projects and initiatives in the Region. Close distance to the developing local Islamic finance markets (Azerbaijan, Kyrgyzstan, Tajikistan, Russia, Uzbekistan and other).

BEST ENVIRONMENT

AIFC will become the centre of local expertise and drive the development of local human capital. To attract best experts, AIFC will provide simplified visa and labor regime as well as tax incentives. AIFC will be the HR nerve centre comprising best educational programmes.



AIFC aims to create a favorable legal and regulatory environment for Islamic financial institutions to establish a new Islamic finance Hub for the CIS and Central Asia in 2020



ISLAMIC BANKING PRODUCTS



**ISLAMIC CAPITAL MARKET
INSTRUMENTS**



**OTHER ISLAMIC FINANCIAL
SERVICES (TAKAFUL, ISLAMIC
LEASING, ETC.)**

Creating a holistic Islamic financial market with all elements in place (banking, capital markets and other Islamic finance services) supported by local and international conventional and Islamic financial institutions

AIFC will create unique architecture for the Islamic finance market



**OFFICE OF THE ISLAMIC
DEVELOPMENT BANK GOVERNOR
FOR KAZAKHSTAN**



**AIFC CENTRAL
INDEPENDENT SHARIA BOARD,
AIFC WAQF FUND**



**POTENTIAL HOST FOR
REGIONAL OFFICES OF
INTERNATIONAL ISLAMIC
FINANCIAL ORGANIZATIONS
(IDB, ICD, AAOIFI, IFSB,
IIFM, CIBAFI, ETC.)**

Incentives and enablers within AIFC



Islamic finance assets to reach 10% of the banking industry in Kazakhstan by 2025;



Develop Islamic finance Blue print;

Promote awareness about Islamic finance products locally, not only among Muslims;



Organize roadshows events in Islamic finance centres;

National Fund and Single Accumulative Pension Fund to be invested into Sukuk;



Provide incentives for Islamic finance institutions and facilitate localization process;



Allow conventional banks to offer Islamic finance products through Islamic windows;

Issue up to \$1.5 bln. of Sukuk on local capital market by 2020;



Level the playing field for the Islamic finance industry.

Islamic finance rules, policy approach & options



Develop a regime which is compliant with IFSB – 15 and other IFSB standards



Ensure compliance with Applicable international standards – Basel Committee, IOSCO, IFSB Core principles



Ensure consistency with the overall structure of the AFSA rulebook



Facilitate growth and establishment of businesses in AIFC

Critical Policy issues

Scope of application – Islamic Banks or IFIs

Definition of a Islamic FI (IFI) will cover all types of activities and businesses – including Takaful. This will help in having a common rulebook for all aspects except Prudential rules.

Definition of Islamic Banks-managing PSIAs or wider definition (CBB)

As managing PSIAs or as carrying out banking business in Shari'ah-compliant manner. Critical as conventional banking business is not allowed in AIFC. Follow CBB approach – IBs as banks with managing PSIAs (no deposit taking).

Islamic Windows

Essential to facilitate business growth in initial stages of AIFC. Enables large conventional banks to enter Islamic financial services. Allow only windows for Authorised Firms of AIFC.

SSB-Individual or Common (Jurisdiction-wide)

IFI-specific or common Shari'ah Supervisory Board (SSB). IFI-specific SSBs – invariably lead to inconsistent developments in market particularly in new markets like AIFC.

Treatment of PSIAs-Smoothing techniques

Segregation of assets of Restricted PSIAs. Unrestricted PSIAs – commingling, Shari'ah compliance, ease of supervision. Profit-Smoothing - potential systemic risk / macro-prudential concerns.

Restricted PSIAs to be segregated and treated as Funds

Restricted PSIAs to be segregated and treated like Funds (COB rules).

Capital Adequacy-compliant with IFSB 15 and Basel standards

Unrestricted PSIAs – allowed with profit-smoothing; Employ DCR capital charges and PER/ IRR requirements.

Kazakhstan offers a unique set of Islamic finance investment opportunities across retail and corporate sectors

AIFC, located in the heart of Eurasia, provides a unique opportunity to access projects and initiatives in the developing Islamic finance markets in the region (Azerbaijan, Kyrgyzstan, Tajikistan, Russia, Uzbekistan and other). AIFC has all the tools to become the regional Islamic finance hub of the CIS region and Central Asia, and shall become a new destination for Islamic financial institutions.

According to the Thomson Reuters Islamic Growth Markets Investment Outlook report, Kazakhstan was ranked 5th as an Islamic investment destination country among 57 OIC member countries in 2015.

The idea of creating a holistic Islamic financial market with all the elements in place (banking, capital markets and other Islamic finance services) widely supported by conventional and Islamic financial institutions from both local and international markets.



REGULATORY LANDSCAPE

- First CIS country to introduce Islamic finance rules in 2009;
- New legal framework for Islamic banking, Takaful, Ijarah and Sukuk, including sovereign Sukuk.



FAVOURABLE DEMOGRAPHICS

- 75% of the total population in Kazakhstan are Muslims and combined Muslim population in CIS – 80 million people;
- Young population is a key retail growth driver – 42% of population are between 24-54 years;
- Increased internet penetration offers financial technology opportunities.



BUSINESS FRIENDLY ENVIRONMENT

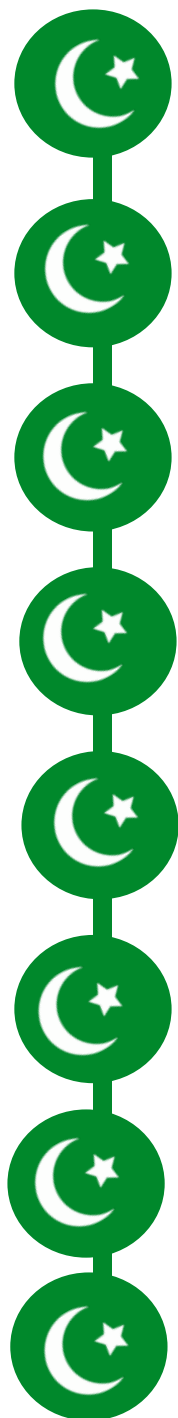
- Remarkable improvement in ease of doing business in 2017, (up 16 positions in ranking);
- Supportive ecosystem for investors presents opportunities to tap market potential.

Chronology and achievements of Islamic finance (1)



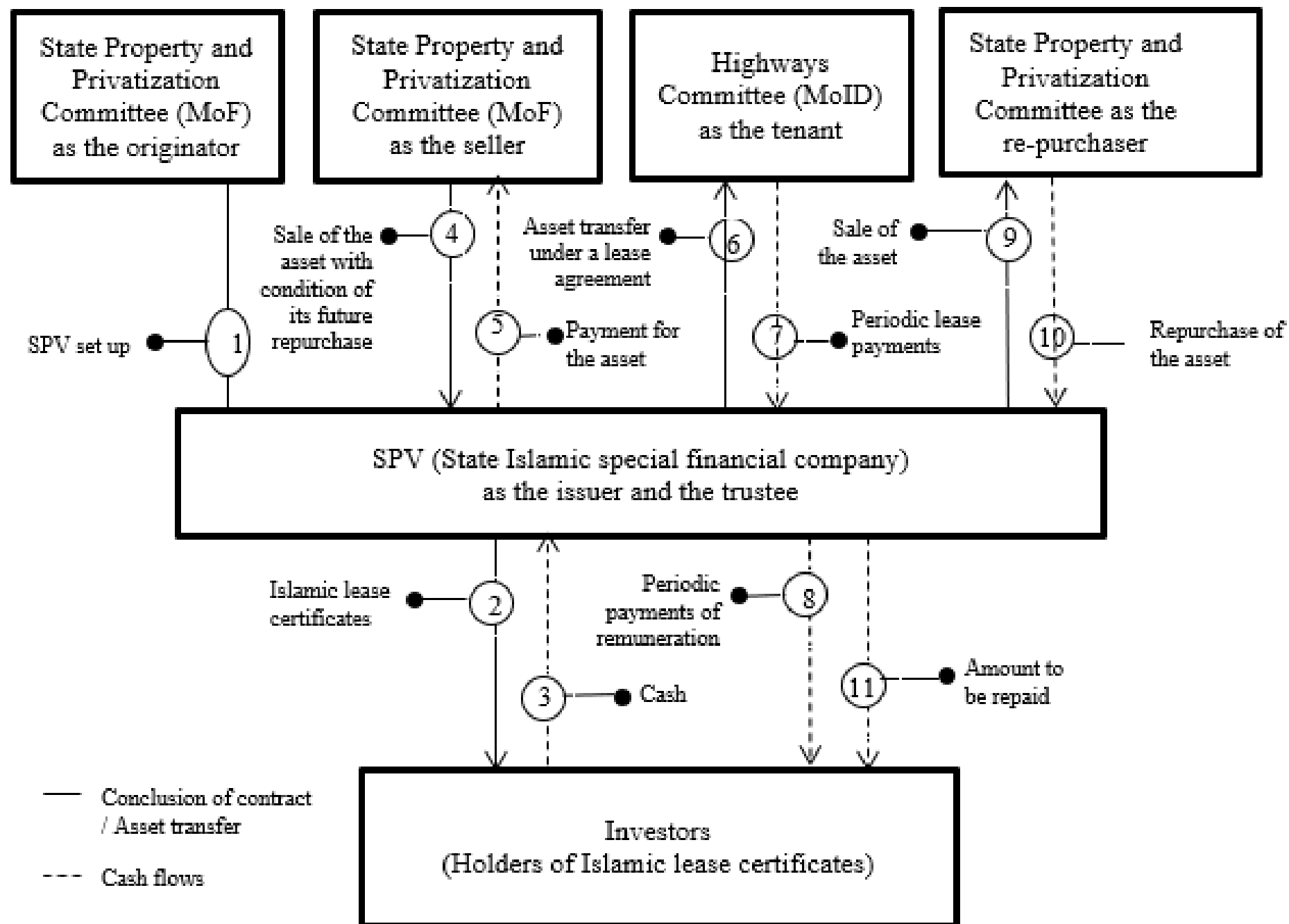
- June, 2009 - the Law of the Republic of Kazakhstan “On Ratification of the Agreement between the Government of the Republic of Kazakhstan and the Government of the United Arab Emirates on the opening of the Islamic Bank in the Republic of Kazakhstan” has been signed. The law served as the basis for the establishment of the first Full-fledged Islamic bank in the country - JSC “Al Hilal Bank” (100% subsidiary of Al Hilal (UAE));
- In 2010 – Establishment of Mutual insurance society “Takaful”;
- In 2010 – Establishment of first Full-fledged Islamic bank JSC “Al Hilal Bank” in Kazakhstan and the region.
- November 2011 – National Bank of Kazakhstan was admitted to the Islamic Financial Services Board (IFSB) as an associate member and became a full member in 2015;
- March 2012 – Decree of the Government of the Republic of Kazakhstan no. 371 approved the Roadmap on development Islamic finance in Kazakhstan until 2020;
- July 2012 – JSC “Development Bank of Kazakhstan” issued Sukuk “al-Murabaha” in the amount of 76.7 million USD (240 million Malaysian ringgit);
- In 2013 – Establishment of Kazakhstan Ijara Company (ICD 30%, Zaman Leasing 18%, and etc.);
- September 2014 - the round table "Development and regulation of Islamic financial institutions" for the regulators of the CIS and Central Asia;

Chronology and achievements of Islamic finance (2)



- December 2014 – the National Bank of Kazakhstan became the Member of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the International Islamic Financial Market (IIFM);
- April 2015 - the Law providing Takaful and Ijara, the recognition of "commodity murabaha" as a banking transaction, tax administration, banking operations of an Islamic bank, procedures of Wakala (acceptance of deposits) in Islamic banks has been adopted;
- May 2015 - the National Bank of Kazakhstan held the 12th IFSB Summit in Almaty;
- November 2015 - the Law providing structure of government Islamic securities issuance and conversion conventional bank into Islamic has been adopted;
- In 2017 – first conventional leasing company (SK Leasing company) converted to Ijara leasing company Al Saqr Finance;
- August 2017 - first conventional Zaman-Bank converted to Full-fledged Islamic bank;
- From 2018 AIFC (AFSA) will be a full member of AAOIFI and IFSB;
- First sovereign sukuk expected in 2018 (Q1,Q2) to set yield curve for corporate issuances.

The structure of Sovereign Sukuk issuance in Kazakhstan



Main challenges for Islamic finance in Kazakhstan



Lack of Islamic Finance professionals working in the regulatory



Undeveloped retail market on Islamic Finance



Islamic windows not allowed



Lack of awareness on Islamic finance products and services.