

Government Financial Stability Measures Are Now Reflected in the Legislation

**Law of the Republic of Kazakhstan
On Changes and Amendments to Certain
Legislative Acts of the Republic of Kazakhstan
regarding Stability of the Financial System
No. 72-IV dated 23 October 2008 (the "Law")**

Summary of the main amendments proposed by the Law:

- ✓ The Government¹ has right to enter into the share capital of the banks in case of (i) a single violation of a capital adequacy coefficient and/or liquidity coefficient; or (ii) violation of other prudential norms twice or more times during 12 months; the stake to be acquired by Government is in the discretion of the Government and depends on the financial position of the bank, but shall not be less than 10% of placed shares.

The Government has right to appoint its representatives into Management Board and/or the Board of Directors in case of acquisition of a stake in a bank. At the same such representatives shall not exceed 30% of members of such body. It is not clear as to whether the Government would appoint less than 30% of its representatives in case it acquires less than 30% stake.

The Government shall alienate stake in bank within one year and has the right to extend such period depending on the banks financial position.

The Law provides with a simplified procedure for the quick Government entry, e.g., no bank corporate approvals are required in connection with acquisition, no preemptive right can be used by existing shareholders, etc.

- ✓ The above "financial stability" measure is added to another/existed measure – compulsory buy-out of a bank stake by the authorized body² (FMSA) in case the capital of such bank is negative. In this case, however, FMSA shall immediately sell such stake to an investor who guarantees improvement of a financial position of the bank.

Both above items are applicable in the event the FMSA "early reaction" measures, discussed below, did not succeed.

¹ The Government right to acquire a stake in a bank can be exercised by the National Managing Company.

² Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations.

- ✓ Bank loan agreements executed with individuals shall provide either fixed or floating interest rate. "Fixed" rate implies that the interest rate shall not be unilaterally changed by the bank during at least three year period. As far as the "floating" interest rate concerned – FMSA establishes the procedure for its calculation. The banks are not allowed to unilaterally increase the rates and calculation of tariffs and other fees related to loan servicing. The Law envisages retroactive effect for provisions in this item, *i.e.*, it is applicable to loan agreements concluded before the October 24, 2008.
- ✓ In case of a mandatory liquidation of a bank, the member of mandatory deposit guarantee system, during a period from October 24, 2008 (the date of effectiveness of the Law) until 1 January 2012, the organization performing mandatory deposit guarantee makes guaranteed compensation payment to depositors – individuals in the deposit amount without accrued interest in the amount of KZT 5 million.

The Law proposes amendments to the following normative legal acts:

1. Criminal Code of the Republic of Kazakhstan dated July 16, 1997 (the "**Criminal Code**");
2. Law of the Republic of Kazakhstan On Banks and Banking Activity in the Republic of Kazakhstan dated August 31, 1995 (the "**Banking Law**");
3. Law of the Republic of Kazakhstan On Pension Provision in the Republic of Kazakhstan dated June 20, 1997 (the "**Pension Law**");
4. Law of the Republic of Kazakhstan On Insurance Activity dated December 18, 2000 (the "**Insurance Law**");
5. Law of the Republic of Kazakhstan On Joint-Stock Companies dated May 13, 2003 (the "**JSC Law**");
6. Law of the Republic of Kazakhstan On Securities Market dated July 2, 2003 (the "**Securities Market Law**");
7. Law of the Republic of Kazakhstan On State Regulation and Supervision of Financial Market and Financial Organizations dated July 4, 2003 (the "**Financial Regulation Law**");
8. Law of the Republic of Kazakhstan On Credit Bureau and Formation of Credit Stories in the Republic of Kazakhstan dated July 6, 2004;
9. Law of the Republic of Kazakhstan On Investment Funds dated July 7, 2004;
10. Law of the Republic of Kazakhstan On Mandatory Guaranteeing of Deposits in the Second-Tier Banks of the Republic of Kazakhstan dated July 7, 2006; and
11. Law of the Republic of Kazakhstan On Accounting and Financial Statements dated February 28, 2007.

Below we highlight certain amendments only.

The Criminal Code is amended by adding a new article which provides for liability for intentional action (non action) of a major shareholder - individual, first executive of major shareholder – legal entity of insurance organization, open pension fund, bank or executive body of insurance organization, pension fund, bank, organization performing investment management of pension assets which led to insolvency followed by mandatory liquidation of insurance organization, opened pension fund, bank.

The Banking Law is amended as follows:

- ✓ The provisions on types of activities prohibited for the banks were amended to include establishment and participation in the activity of noncommercial organizations. However, participation in financial organizations and organizations which purchase non performed claims of second tier banks for management and/or its following realization, restructuring and/or securitization is allowed.
- ✓ The Banking Law provisions related to procedures on obtaining and revocation of FMSA permission for acquisition of “substantial” participation³ are amended.
- ✓ The procedure of voting at the general shareholders meeting is slightly amended by requirement of a statement from shareholder that neither he, nor his affiliates, is registered in off-shore zones in case such information is not available in the bank.
- ✓ The clause providing that the requirement on obtaining of FMSA consent for acquisition of status of “bank holding” does not apply to financial organizations, non residents of Kazakhstan that are subject to consolidated supervision in a country of residence has been removed.
- ✓ For obtaining of approval on bank holding, a financial organization – non-resident of Kazakhstan that is subject to consolidated supervision in a country of its residence, shall submit the following documents:
 - a document confirming minimum required rating of the rating agencies, list of which is determined by FMSA;
 - written confirmation of the financial supervision body of a country of residence of the applicant of consolidated supervision of the applicant;
 - written approval of a financial supervision body of a country of residence of applicant on acquisition of a status of a bank holding or confirmation of the authorized body of applicable state that such approval under legislation of the state is not required.
- ✓ The Law specified another basis for FMSA revocation of its consent on status of major participant or a bank holding, *i.e.*, the consent can be revoked in case acquisition of such status entails violation of the antimonopoly legislation of Kazakhstan.
- ✓ Besides, FMSA can make a decision on termination of its consent for major participant or banking holding in case their stake become less than 10 percent or 25 percent in a bank respectively.
- ✓ The Law specifies the procedure of Government acquisition of a bank stake under the basis discussed in the first item of the Summary above. The Government entry into share capital would be made through issue (if there are no outstanding shares) and placement of new shares of the bank, *i.e.*, no purchase from existing shareholders would be made. The Government itself makes a decision on acquisition and determines the purchase price (based on FMSA recommendations and subject to approval by the National Managing Company or state body competent on disposition of state property) and no bank corporate approvals would be required in connection with acquisition. The purchase price should be based on the market price; an appraiser company might be involved for price determination and its fees shall be born by the bank. Upon completion of acquisition, a state body competent on disposition of state property or a national managing holding convenes

³ “Substantial” participation is, *inter alia*, holding of directly or indirectly of 20% or more of the voting shares in a company.

extraordinary general shareholders meeting for consideration of issues of replacements of officers or employees of a bank, optimization of assets, increase of charter capital and other issues.

- ✓ Article 45 of the Banking Law related FMSA measures in case of worsening of bank's financial position was restated in a new wording to extend and clarify as to what measures can be taken. In particular, the mentioned article now specifies that FMSA monitors/analyses the following factors:
 - (i) Reduction of capital adequacy ratio;
 - (ii) Reduction of liquidity ratio;
 - (iii) Reduction of a share of deposits of individuals and legal entities in the total liabilities of a bank;
 - (iv) Increase in volume of the loan portfolio of the loans of the bank, where payment of principal and interest delayed over 90 calendar days; and
 - (v) Any other factors that influence worsening of a financial condition of a bank, under FMSA regulations.

If the above factors are discovered as result of FMSA audit, then a bank and its shareholders would be required by FMSA to submit plan of measures including so-called "early reaction" steps in connection with improvement of a bank financial stability, prevention of worsening of bank financial position as well as risks related to its activity. The bank and/or its shareholders shall elaborate such plan, specifying deadlines, within 5 working days since receipt of FMSA relevant instruction. If FMSA approves the plan, the bank starts its realization keeping FMSA informed as to the status. If FMSA does not approve the plan, it may enforce any or several of below "early reaction" measures:

- (i) change in organizational structure and/or staff size;
- (ii) limitation on accepting deposits;
- (iii) cease of accrual and/or payment of dividends for a period specified by FMSA;
- (iv) increase of bank provisions;
- (v) removal of management staff and other employees;
- (vi) suspension or limitation of certain high risk banking operations;
- (vii) increase of bank own capital, by the amount adequate for stabilization, including though increase of a share charter capital;
- (viii) restructure of bank assets; and
- (ix) reduction of administrative expenses, including through suspension or limitation of hiring personnel, close of certain branches and representative offices as well as subsidiaries; and reduction of a bank share in "dependant"⁴ companies within and outside Kazakhstan.

The *Pension Law* and *Insurance Law* have also been amended to include the concept of "early reaction" measures similar to above.

- ✓ The Banking Law in Article 47-1 provides that FMSA may enforce compulsory measures towards major shareholders, banking holdings and entities within the banking conglomerate in certain cases. Under the Law, such measures may also be applied towards persons/entities that have features of major shareholder or a bank holding.

⁴ Under the Civil Code, a company is deemed "dependant" in case the other company holds more than 25% of the voting shares.

- ✓ Certain provisions of the clause regulating voluntarily liquidation were changed. Thus, after making decision on voluntarily liquidation bank has to take measures to repay deposits of individuals by way of its direct repayment or transfer to another bank, member of mandatory deposit guarantee.

JSC Law has been amended to widen grounds based on which a shareholder may demand redemption of his shares: (i) in case the general shareholders meeting resolves to delist shares of the company (in case such shareholder voted against the delisting) and (ii) in case the stock exchange resolves to delist the shares of a company. The exclusive competence of general shareholders meeting is amended to add decisions on voluntarily delisting of shares of a company.

The Securities Market Law is amended to add new definitions. The procedure of registration of securities transactions and confirmation of rights to the securities have been changed and specified in more details. Article 56 of the Securities Market Law related to "price manipulation" transactions has also been restated. It is now clarified that a transaction executed on stock exchange can be recognized as "price manipulating" by FMSA based on expert report/opinion of the Board of Directors of such stock exchange. The Law further clarifies the procedure and members of such expert commission of Board of Directors of stock exchange. Besides the Law extended the list of "price manipulating" transactions.

The Financial Regulation Law is amended as follows:

- ✓ FMSA appoints its representative(s) to a bank for supervision purposes. The number of representatives for each bank to go is determined by FMSA.
- ✓ FMSA representative performs the following functions: 1) analyses financial condition of a bank; 2) controls compliance with FMSA regulations, instructions, prescriptions, requests; 3) makes suggestions on FMSA audit of a bank; 4) attends meetings of the Executive Body and Board of Directors, permanent or temporary commissions (working groups) of a bank as an observer; and 5) attends general shareholders meeting as an observer without voting rights and not opining on issues of agenda
- ✓ FMSA representative has the following rights: 1) to request (in oral or written form) from a bank and/or its officers information and documents, including financial statements and materials of meetings (including those, held in absence) of the bodies of a bank with a purpose of performing its functions; and 2) have an access to the automated systems and data bases without possibility of correction of data (reading regime).
- ✓ FMSA representative shall: 1) inform FMSA about denial or delay in provision of documents and other requested information, facts of impending to perform his functions, bribery and threats or illegal influence towards him; 2) perform other functions of specified by FMSA upon appointment.
- ✓ The bank, to which the FMSA representative has been sent, shall: provide assistance to the representative; on-timely provide all requested documents; provide access to the information and data; etc.
- ✓ FMSA representative is liable for disclosure of confidential information obtained during performance of his duties.

The Pension Law and the ***Insurance Law*** are amended mostly in part of requirements to major shareholders having direct or indirect control, "early reaction" measures, mandatory measures in relation to major shareholders and persons, entities having features of a major shareholder, reporting requirement of major shareholders and other changes.

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The Law is in effect since October 24, 2008 (the date of its first publication). Certain amendments, however, come into effect in other/later dates.

Financial organizations shall bring their activities in compliance with the Law before April 24, 2009.

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