

KAZAKHSTAN  
ISLAMIC FINANCE 2016

# A NEW FRONTIER FOR ISLAMIC FINANCE

EXCLUSIVE STRATEGIC PARTNER



NATIONAL BANK OF KAZAKHSTAN



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CIBAFI

المجلس العام للبنوك  
والمؤسسات المالية الإسلامية

General Council for Islamic  
Banks And Financial Institutions



المعهد الإسلامي للبحوث والتدريب  
ISLAMIC RESEARCH AND TRAINING INSTITUTE  
A MEMBER OF THE ISLAMIC DEVELOPMENT BANK GROUP





I INVITE ALL PARTICIPANTS OF THE GLOBAL ISLAMIC FINANCIAL SERVICES INDUSTRY TO JOIN OUR EFFORTS IN REVIVAL OF THE SILK ROAD, BY EXPLORING POSSIBLE WAYS OF PARTNERSHIP, IN ORDER TO COMMEMORATE THE TWENTY-FIRST CENTURY AS THE AGE OF PROGRESS OF THE ISLAMIC FINANCIAL SYSTEM.

The President of the Republic of Kazakhstan, Nursultan Nazarbayev



“Kazakhstan Ijara Company” JSC is the leasing company, acting in accordance with the principles of Sharia, offers Islamic financing from 2014 for companies in the SME and corporate sector.

We are very happy to announce that we have complete 2 years of operation in Kazakhstan and had strong client portfolio. So far, we have founded many projects in Almaty, Astana, Kyzylorda, Shymkent, Aktau, the company continues to carry out projects in other regions of Kazakhstan.



### Milestone



### Our shareholders:

-  Islamic Corporation for Development of Private Sector (ICD)
-  Zaman Leasing (Republic of Kazakhstan)
-  Aktif Yatirim Bankasi AS (Turkey)
-  Al Hilal Leasing (Republic of Kazakhstan)
-  Kolon World Investment Co. Limited (Hong Kong)
-  Eurasia Group AG (Switzerland)

### Targeted clients

- SME & corporate companies (JSC, LLP, IE)
- Companies that are not start-up
- Companies with good business background and positive cash generation
- KIC do not provide leasing services to the legal entities and individual entrepreneurs, that have activity in **gambling, production or trade facility in alcohol and tobacco.**

### Financing conditions

- **Funding amount:** up to 2 mio USD
- **Lease term:** min. 3 years
- **Advance payment by client:** min 20%
- **The rate of return:** individually, depending on the project
- **Documentation fee:** 1% from funding

- Shariah compliant lease
- group of local and international investors
- behaving as solution partner
- collaboration with official vendors
- flexible payment
- in standard transactions no additional collateral is required
- Client does not use full amount of investments from working capital

### Lease assets



### Our contacts

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*As Your partner we are more than leasing company*

President of Islamic Development Bank (IDB)  
Group Ahmed Muhamed Ali speaks during  
the "Third IDB 1440H Vision Commission  
Meeting" in Kuala Lumpur March 23, 2006.  
REUTERS/Zainal Abd Halim



## ABOUT THE ISLAMIC RESEARCH AND TRAINING INSTITUTE



A MEMBER OF



The Islamic Research and Training Institute (IRTI), a member of the Islamic Development Bank Group (IDBG), was established in 1401H (1981). The principal aim of IRTI is to undertake research, training and advisory activities in Islamic Economics and Islamic Finance to facilitate the economic, financial and banking activities in IDB member countries to conform to Shari'ah. A knowledge-based organization, IRTI, is considered to be one of the pioneers and key centers of excellence around the world in promoting and supporting the development and sustenance of a dynamic and comprehensive Islamic Financial Services Industry (IFSI), which supports the socio-economic development of IDB member countries and Muslim communities across the globe.

**VISION** To be the global knowledge center for Islamic Economics and Finance by 1440H (2020)

**MISSION** To inspire and deliver cutting edge research, capacity building, advisory and information services in the area of Islamic Economics and Finance

### IRTI SERVICES

#### ADVISORY AND CONSULTANCY

IRTI provides comprehensive advisory and consultancy services in the fields of Islamic Finance and Economics with global outreach to the public and private sectors. Backed by over three decades of industry experience, IRTI's advisory and consultancy services add real value to the clients' businesses. In addition to IRTI's renowned experts, IRTI utilizes industry experts, affiliate partners and IDB Group members entities' experts to provide advisory and consultancy services to clients. IRTI's consultancy services include (but not limited to): setting up regulatory framework, developing new Islamic financial products and services to cater to the market needs, Shari'ah research, Shari'ah toolkits, Shari'ah guidelines, introduction of Islamic

banking windows in conventional banks, conversion to Islamic banking, Shari'ah auditing exercises, Shari'ah advisory and technical support for sukuk issuance etc.

#### RESEARCH

IRTI is a catalyst in the advancement of the Islamic Economics and Islamic Finance fields. Currently IRTI's research agenda is focused on five clusters, namely: Islamic Financial Institutions and Financial Sector Development, Islamic financial products development, Financial Stability and Risk Management, Economic development in OIC member countries, and Human development in light of Maqasid Al Shari'ah.

#### INFORMATION AND KNOWLEDGE SERVICES

IRTI effectively and efficiently creates, captures and disseminates knowledge using traditional and modern information systems and programs. These programs include, but not limited to; the internet, social media, e-learning, distance learning, voice and video conferences.

#### ISLAMIC FINANCIAL INDUSTRY INFORMATION CENTER (IFIIC)

IFIIC is a portfolio of online applications and databases with relevant data about the Islamic Financial Industry. Components of the IFIIC are the following: Islamic Banking Information System (IBIS, [www.ibisonline.net](http://www.ibisonline.net)), Shariah and Who's Who Databases.

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## About CIBAFI

General Council for Islamic Banks and Financial Institutions (CIBAFI) is a non-profit institution that is the umbrella for Islamic financial institutions worldwide. It was founded by the Islamic Development Bank (IDB) and a number of leading Islamic financial institutions, CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC). Established on 16 May 2001, in the Kingdom of Bahrain, today CIBAFI is recognised a key piece in the international architecture of Islamic finance.

CIBAFI was established with the objectives of developing the Islamic financial services industry (IFSI) and promoting the industry in various fields through information and financial analysis, communication, awareness, human resources and rating of Islamic financial products.

CIBAFI was founded by Islamic Development Bank and 30 members. Now, after 13 years of operations, CIBAFI has 111 members. Membership is spread across 28 jurisdictions in the Middle East, Africa, Europe as well as South and Central Asia and includes Islamic financial institutions, multilateral banks, international standard setting organisations and other professional services firms.

## To this extent, initiatives of CIBAFI include:

- 1: Policy, Regulatory Advocacy**
- 2: Research and Publications**
- 3: Awareness and information sharing**
- 4: Professional Development**





▲  
A general view of Kazakhstan's  
commercial city of Almaty.  
REUTERS/Shamil Zhumatov

# Foreword

The Kazakhstan Islamic Finance Report is the sixth in our series of Islamic Finance Country Reports (IFCR), designed to provide analysis and key insights on the current development and future potential for Islamic finance in emerging and frontier Islamic finance markets.



**Mustafa Adil**

The global Islamic finance industry has demonstrated exceptional growth over the years to reach over \$1.8 trillion in assets. This growth has primarily been driven by core markets, where the industry has moved from a niche segment to a genuine alternative to the conventional banking industry.



**Abdelilah Belatik**

However, outside of core markets, Islamic finance remains underpenetrated. In the top ten Islamic finance markets, Islamic finance assets account for 35% of banking assets, on average. However, this drops to 5% market penetration for the next ten markets.



**Dr. Mohamed Azmi Omar**

This demonstrates the great potential that these markets offer. And as the industry matures in core markets and growth rates reduce, it will be these emerging markets that will be the growth drivers for the industry in the next decade.

One of these emerging markets which is on the radar of the industry is Kazakhstan. The country has all the key requirements to not only establish a successful domestic Islamic finance market, but to also position itself as a regional hub for Islamic finance in Central Asia and the CIS region.

Despite the recent impact on the economy due to declining oil prices, and the recent devaluation of the Tenge, Kazakhstan still has the required fundamentals that make it a very attractive market for the Islamic finance industry.

The country has a positive economic outlook, strong domestic demand and major infrastructure projects in the pipeline. All these factors, coupled with the government support being demonstrated, and the legislative regime being introduced to support the industry, point to a strong base which will facilitate the growth of this industry.

With that, It gives us great pleasure to present the Kazakhstan Islamic Finance Report. We hope this

report will provide you with the information and analysis required to better understand the current state and future potential of the Islamic finance industry in Kazakhstan.

We have no doubt that in the coming decade, we will not only see the growth of the Islamic finance in Kazakhstan, but we will see it as a pillar for the growth of the global Islamic finance industry.

**Mustafa Adill**  
Head of Islamic Finance  
Thomson Reuters



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**Abdelilah Belatik**  
Secretary General  
CIBAFI



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Director General  
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# Executive Summary



Kazakhstan's economy is expected to gradually moderate in 2016 after experiencing a slowdown in 2015 caused largely by the sharp drop in oil prices. GDP growth is estimated at 2.4% in 2016, up from 1.5% in 2015. However, external demand is expected to remain weak, as Kazakhstan faces lower levels of demand from its two major trade partners and sources of investments: China and Russia. No longer pegged to the U.S. dollar from 2015, the tenge's devaluation has also put pressure on exchange rates and is likely to affect private consumption and credit growth in the long run.

Kazakhstan remains politically stable and its government has plans to strengthen public and market institutions. The country has made remarkable progress in creating jobs, reducing poverty, and sharing prosperity based on job creation and higher wages. The availability of more jobs has also led to upward social mobility and the rise of the middle class.

The country is still emerging with a stable and prosperous economic outlook. It has large international investments in its oil and gas sectors, and economic diversification plans are underway.

## FOCUS ON ISLAMIC FINANCE

Kazakhstan passed its first laws for Islamic banking in 2009, thereby becoming the first country in the CIS to facilitate the development of Islamic finance. This development is still in its infancy, and is expected to grow progressively in the next few years; the government is increasingly committed to creating a supportive ecosystem for Islamic finance in Kazakhstan.

The Kazakh government wants to foster ongoing economic diversification and attract more foreign investments into non-oil sectors, and Islamic finance is seen as one key avenue to finance important projects aimed at improving transport infrastructure, developing a future ICT infrastructure, and strengthening public and market institutions.

# ABOUT THOMSON REUTERS Islamic Finance

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## Global Information Provider

Combining industry expertise innovative technology, our information services cover deep coverage of Islamic finance news, market insights and Shariah-compliant pricing data, indices, screening solutions, regulation, standards, and more.



## Leading Research House

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## Global Growth Solutions

Thomson Reuters consulting professionals include renowned experts with subject-matter know-how and extensive experience in all major areas of the Islamic financial services industry, including deep understanding of Shariah law.



## Global Community

With more than 100,000 clients in over 30 industries in more than 100 countries worldwide, we have built a growing global network with major decision making executives from top governments and leading institutions.



**Salaam Gateway** is the global reference for industry intelligence, news, information, and data from the Islamic Economy. Our news and research resources and extensive database of Islamic Economy companies from across the globe, help professionals to advance their businesses and fuel their innovations. Our insights and intelligence come from Islamic Economy experts, industry analysts, and thought leaders.

[www.SalaamGateway.com](http://www.SalaamGateway.com)

**TO VIEW OUR IFG RESEARCH SOLUTIONS: <http://www.zawya.com/ifg-publications>**

To contact us, please go to <https://forms.thomsonreuters.com/ifgbusiness>

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## CHANGING LANDSCAPE FOR ISLAMIC FINANCE

There is currently only one Islamic bank in Kazakhstan – Abu Dhabi’s Al Hilal Bank, established in 2010, offers both corporate and retail services.

From this one Islamic bank, the industry is set to grow as Kazakhstan now has the legal framework for Islamic banking, sukuk, takaful, and ijarah (leasing).

Nonetheless, it is imperative to note that the legal framework introduced in 2009 for Islamic banking did not permit the conversion of conventional banks into Islamic ones, nor did it allow conventional banks to offer Islamic banking products. New amendments have been introduced and were only approved in November 2015. The amendment provisions to facilitate the conversion of conventional banks into Shariah-compliant ones and permits Islamic windows too. With this,

### KEY INSIGHTS

01

#### Recent Developments



- Expected economic recovery in 2016
- GDP growth of 2.4% in 2016 and 4.8% in 2017
- Establish Astana International Financial Centre (AIFC) as a regional Islamic finance hub
- Assessment to establish a National Shariah Supervisory Committee (non-governmental)
- Islamic Finance Training Center in RFCA Academy
- Association of Islamic Finance Development (ADIF) established in 2009

02

#### New Islamic Finance Laws



- Conversion of conventional banks to Islamic ones by early 2016
- Takaful firms to segregate assets owned by policy holders
- Ijarah companies to operate without licenses from the central bank
- Reduce working capital from 10 billion tenge to 5 billion

03

#### Islamic Banking



- One Islamic bank: Al Hilal Bank
- Interest from new Islamic Banks: Al Baraka and Maybank Islamic
- New Islamic bank expected in late 2016 or early 2017
- Survey of large untapped Islamic banking retail consumers’ demand
- Islamic banking share to reach 5% by 2020
- Microfinance can be successful in reaching rural areas and providing access to finance

Islamic banking is expected to grow progressively in the next few years as competition is likely to increase when more products are introduced.

These developments are driven by presidential and governmental reforms to create an enabling environment for Islamic finance, which will make the country's financial markets more competitive and attractive to Shariah-compliant investment capital from major Islamic financial markets. In

2012, Kazakhstan's government introduced a 41-point plan – "Road Map for Development of Islamic Finance by 2020." The plan aims to mobilize support by public and private institutions for Islamic finance in terms of legislative improvements, market education, Islamic financial infrastructure, development of the public sector, Islamic financial services, science and education, and investor relations.

## 04

### Islamic Capital Markets



- Kazakhstan set to debut sovereign sukuk in early 2016
- Corporate sukuk is expected to attract more Shariah-compliant capital

## 05

### Takaful



- Low insurance penetration presents opportunities for takaful
- Young and growing middle class with rising incomes present an opportunity for family takaful

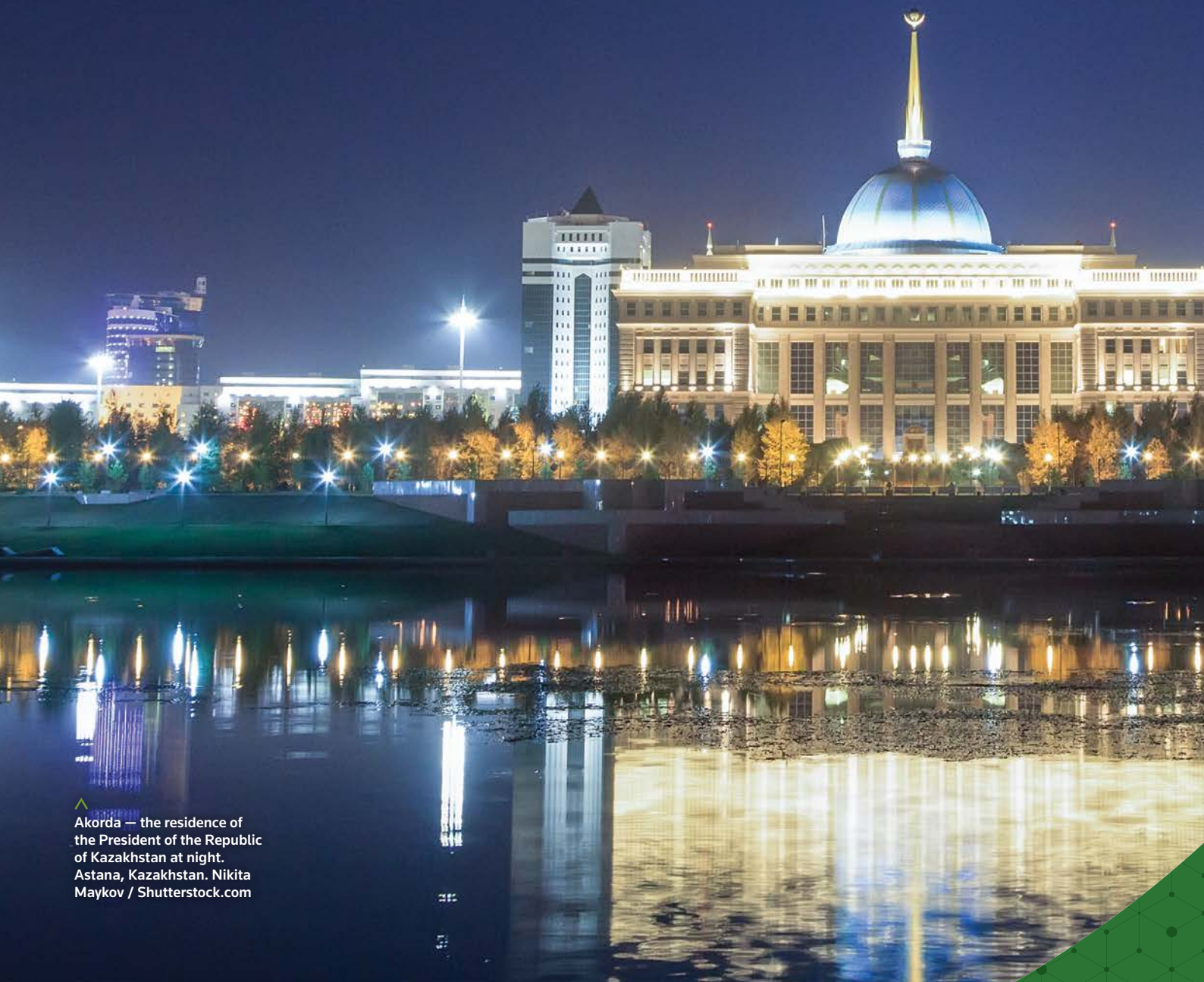
## 06

### Challenges



- Lack of understanding is the biggest hurdle to Islamic banking growth in Kazakhstan
- More technical and capacity building is required for Islamic finance
- Awareness remains a challenge to be tackled through increasing Islamic finance activities and education programs

# 1 Macroeconomic Outlook

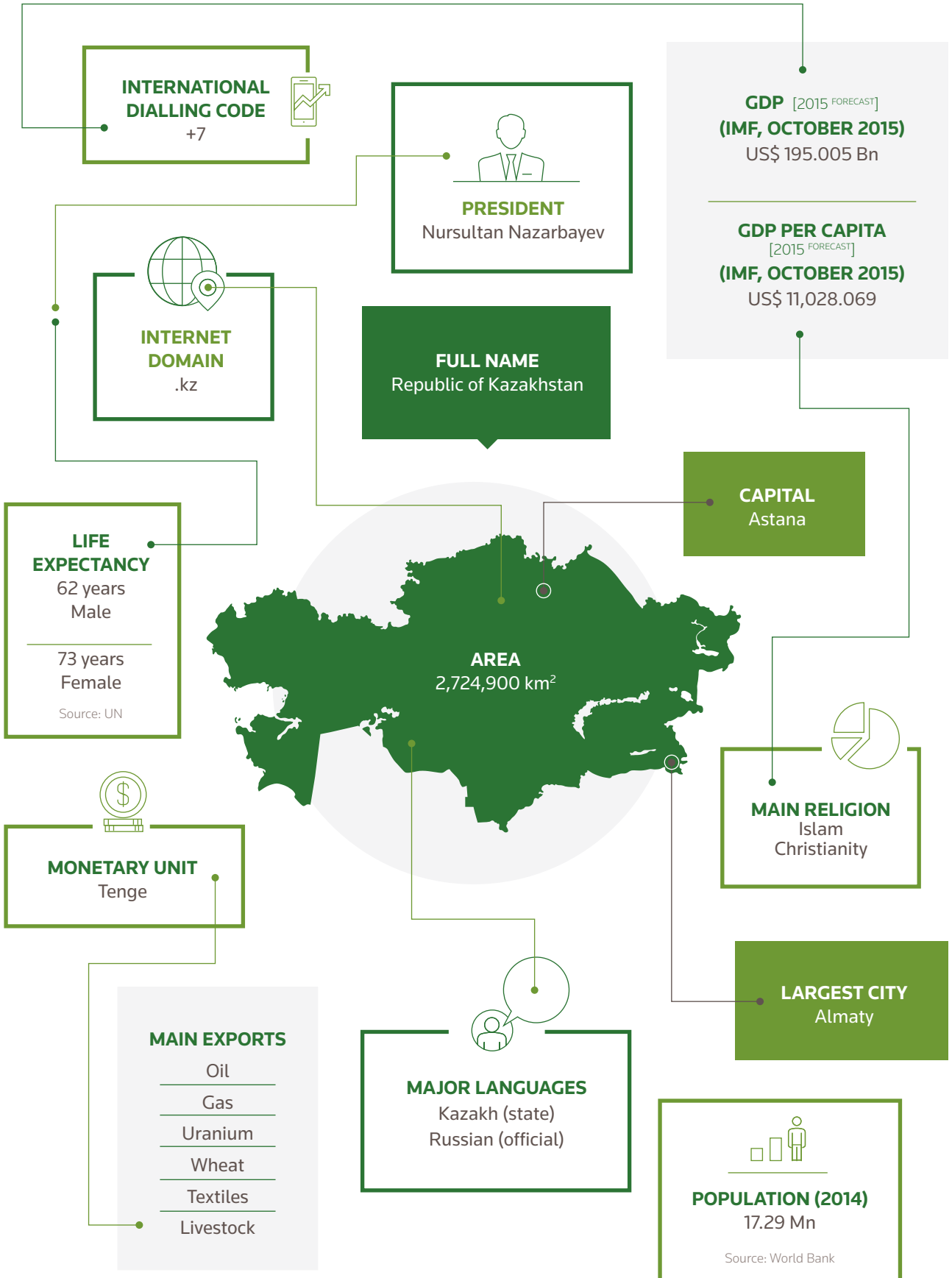


▲  
Akorda — the residence of  
the President of the Republic  
of Kazakhstan at night.  
Astana, Kazakhstan. Nikita  
Maykov / Shutterstock.com



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## 1. MACROECONOMIC OUTLOOK

**01. WEST KAZAKHSTAN**  
Population: 618,261  
—

**02. ATYRAU**  
Population: 556,388  
—

**03. MANGYSTAU**  
Population: 596,706  
—

**04. AKTOBE**  
Population: 797,036  
—

**05. KOSTANAY**  
Population: 880,227  
—

**06. KYZYLORDA**  
Population: 727,990  
—

**07. SOUTH KAZAKHSTAN**  
Population: 2,685,009  
—

**08. NORTH KAZAKHSTAN**  
Population: 579,403  
—

**09. AKMOLA**  
Population: 733,113  
—

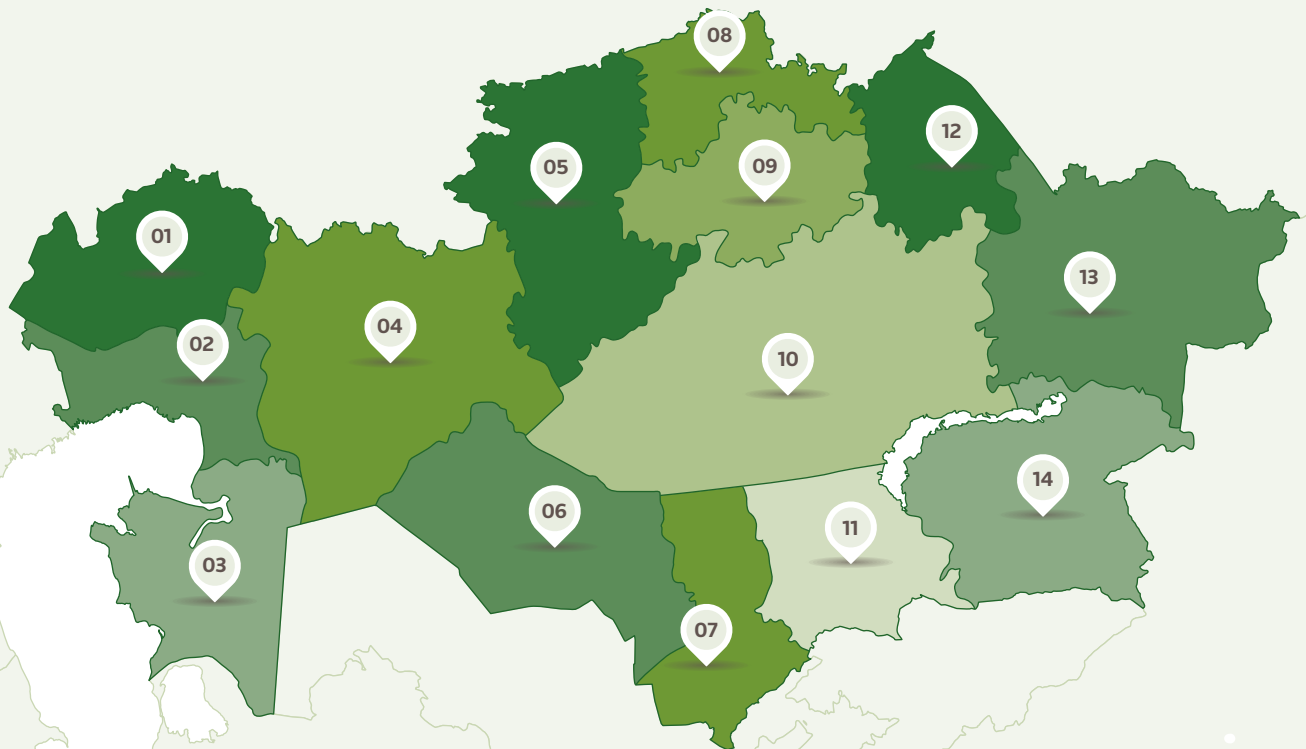
**10. KARAGANDY**  
Population: 1,363,638  
—

**11. ZHAMBYL**  
Population: 1,071,645  
—

**12. PAVLODAR**  
Population: 749,516  
—

**13. EAST KAZAKHSTAN**  
Population: 1,393,932  
—

**14. ALMATY**  
Population: 1,949,837  
—



Source: [https://en.wikipedia.org/wiki/Regions\\_of\\_Kazakhstan](https://en.wikipedia.org/wiki/Regions_of_Kazakhstan)

# Snapshots of Macroeconomic of Kazakhstan

## The largest country in the Central Asia



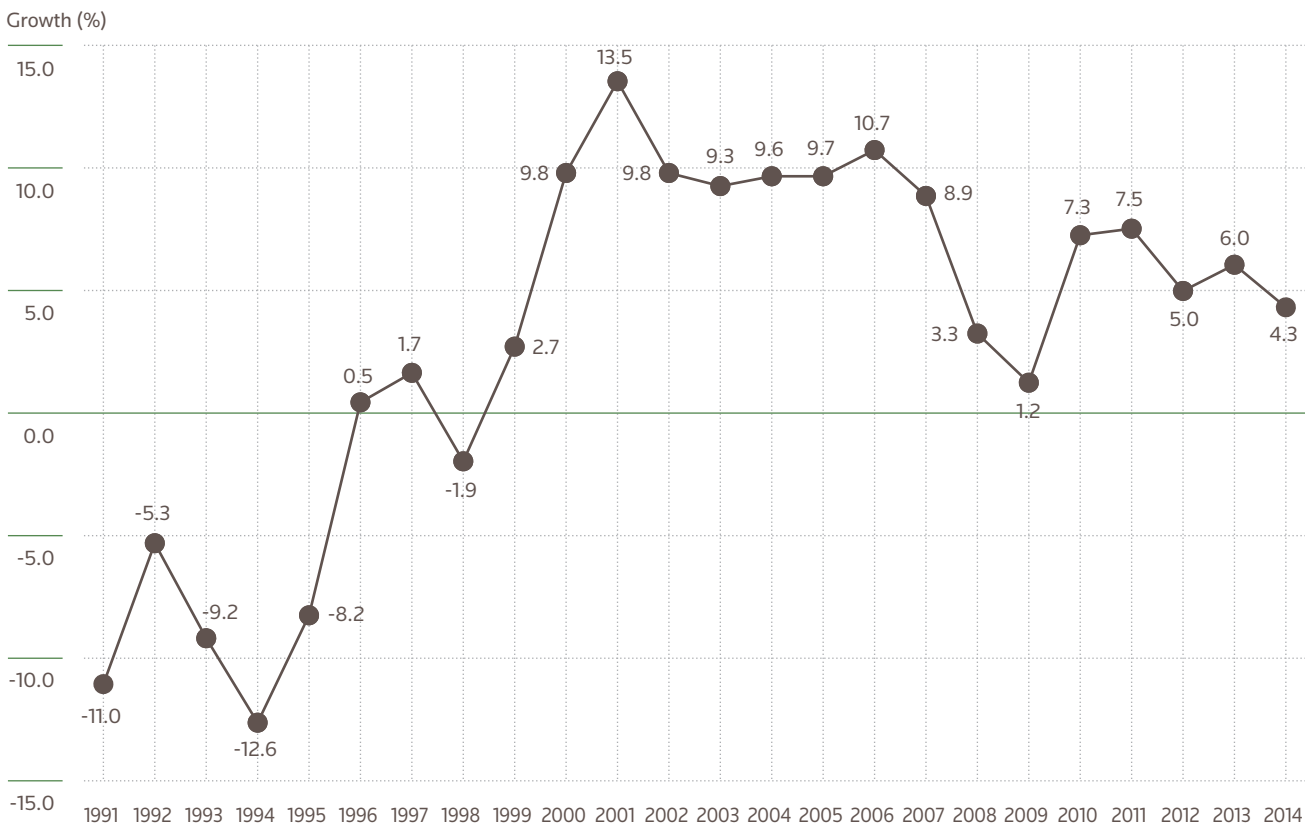
The Republic of Kazakhstan, the world's largest land-locked country, is the ninth largest country in the world with a territory of 2.7 million square kilometers. It occupies a pivotal space of great geo-strategic importance. Kazakhstan is the only Central Asian republic that shares borders with both Russia (6467 km) and China (1460 km). On its western

border is the Caspian Sea. Other bordering countries are Uzbekistan (2300 km), Kyrgyzstan (930 km) and Turkmenistan (380 km).

## Leader among the CIS countries in the pace and quality of transformation reforms

The Republic of Kazakhstan has undertaken vigorous reforms in the area of price liberation, trade barriers, and small and medium scale enterprises privatization in the earlier stage of indepen-

### GDP GROWTH RATE FROM 1991-2014 (%)



Sources: World Development Indicators, the World Bank, 28 July, 2015.

dence. Over the years, Kazakhstan has gradually strengthened its sovereignty, and achieved important economic reforms, which paved the way for impressive economic growth over the years.

### Remarkable Macroeconomic Performance

Kazakhstan has experienced severe economic contraction in the early 1990s due to the collapse of the demand and supply networks from the former Soviet Union countries as results of its heavy dependence on the Russian economy. There was about 40 percent fall in the real GDP over the first half of the 1990s<sup>1</sup>. The economy then recovered slightly in 1996 and 1997 before being hit again by Russian crisis in 1998.

Following a lackluster performance in 1995-99, due to the stabilization and liberalization policies adopted from the mid-1990s<sup>2</sup>, the economy stabilized and Real GDP grew rapidly at an average of over 10% annually between 2000 and 2006. The growth rate was 9.8% in 2000 and a remarkable 13.5% in 2001. Even though there was also significant growth in other sectors, such as mining, food processing and services, this period of boom in real GDP growth stemmed largely from oil production and exports.

Due to its heavy dependence on oil and gas exports, Kazakhstan’s economy was hit again with the onset of the global credit crunch and subsequent economic downturn worldwide. The GDP growth slowed down by 1.8 percentage points in 2007, followed by a sharp slowdown in 2008 as the worsening global economic conditions resulted in lower oil and commodity prices.

### GDP PER CAPITA US\$ (IN CURRENT PRICES)



Sources: World Development Indicators, the World Bank, 28 July, 2015.



KAZAKHSTAN IS RATED BETTER THAN  
RUSSIA, GEORGIA OR ANY OTHER  
NON-EU FORMER SOVIET REPUBLIC.  
THE WORLD BANK'S DOING BUSINESS  
2016 RANKED KAZAKHSTAN 41<sup>ST</sup>,  
UP FROM 53<sup>RD</sup> IN 2015.

In the same time, the bust of the real estate market together with the massive devaluation of the tenge weakened the banks' balance sheets as it increased dramatically the banking sector's external debt burden in tenge terms. As a result, a large fiscal support (7.5% of GDP) was taken to support the banking sector and other measures were taken to support economic activity.

In 2010, Kazakhstan's economy recovered rapidly, buoyed by the rise in the commodity prices due to global economic recovery and ongoing government stimulus and investment. The growth rate was 7.3% and 7.5% for 2010 and 2011 respectively. Kazakhstan's growth rate remained at a moderate level of 5% in 2012 and 6% in 2013, even though this was still lower than before the global crisis. Growth slipped to 4.3% in 2014 due to worsening conditions with a sharp decline in oil prices and spillover from sanctions on the Russian Federation, a major trading partner, but the growth was still higher than the world average of 3.3% in 2014.

Given the heavy dependence on oil and gas, and with its major trading partners being Russia and

China, the future prospects of Kazakhstan's economy very much depend on external conditions.

### **Impressive Socioeconomic Development**

During the last two decades, Kazakhstan emerged as one of the most vibrant, fast-growing economies not only among Central Asian republics, but also among other CIS countries. Moreover, during this period main social indicators substantially improved and the incidence of poverty noticeably declined. Kazakhstan ranked as one of the best among CIS countries in terms of GDP per capita, which stood at US\$13,611 in 2013 and US\$12,276 in 2014, up from US\$1,229 in 2000. Kazakhstan is now a middle-income country as determined by World Bank Classification.

### **Rich in vast natural resources**

Kazakhstan is endowed with substantial natural resources. It possesses significant fossil fuel reserves, along with mineral and metal deposits.

Its mineral resources include the world's largest chromium, vanadium, bismuth and fluorine reserves. Kazakhstan is also a major producer of iron, coal, uranium, lead, zinc, tungsten, molybdenum, borates, phosphorite, copper, potassium and cadmium. Kazakhstan is the world's largest producer of uranium and it owns the world's largest uranium reserves. Oil and gas is the leading economic sector. Natural resources not only contributed to the past growth of Kazakhstan but also will play a key role for sustainable economic growth. Nevertheless, Kazakhstan still needs to diversify its economic structure in order to reduce its vulnerability to external conditions.

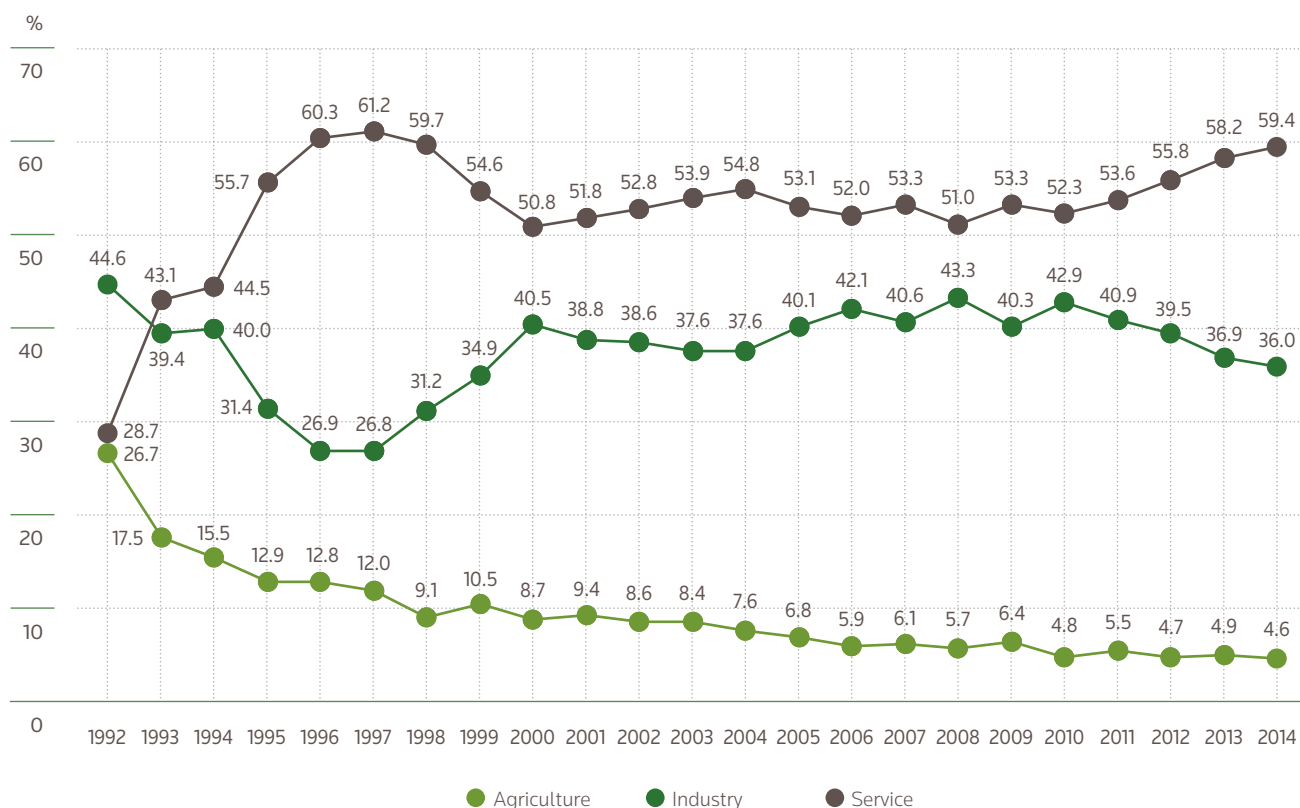
past decades, the economy's structure has not changed much, and the hydrocarbon sector continued to dominate. As demonstrated in the Figure, the structure of the economy has undergone some changes between 1992 and 2014. Since agriculture experienced slower growth throughout this period, its share in the total value added has significantly declined from 26.7 percent in 1992 to 4.6 percent in 2014. This is consistent with the development route experienced by developed countries throughout their development history – the share of primary sectors steadily declined in their output, while manufacturing and service sectors gained additional share.

### Less diversified economy

Although Kazakhstan has made significant advances in terms of real GDP growth over the

The share of the service sectors has markedly improved over the years. However, a cursory look shows that the share of industry in GDP follows closely with the movement of commodity prices,

STRUCTURE OF GDP (%)



which indicates its heavy dependence on the oil and gas. As per the statistics, the share of oil and gas industry in total GDP increased from 10.9% in 2001 to 25.2% in 2012, making the oil and gas industry one of the main drivers of GDP growth, and one that plays a vital role in Kazakhstan's GDP structure. Thus, soaring prices of oil, minerals, and other commodities have helped lifted GDP of Kazakhstan since 2000.

### Improved Business Environment

The latest Global Competitiveness Report for 2014–2015 ranked Kazakhstan 50 among the 148 countries surveyed. Kazakhstan is rated better than Russia, Georgia or any other non-EU former Soviet republic. The World Bank's Doing Business 2016 ranked Kazakhstan 41<sup>st</sup>, up from 53<sup>rd</sup> in 2015. Nevertheless, Kazakhstan has been trying to improve its business conditions over the years, especially by protecting investors, and making it easier to acquire construction per-

mits and for entrepreneurs to launch startups. According to the Heritage Foundation's Index of Economic Freedom, Kazakhstan's economic freedom score is 63.3, making its economy the 69<sup>th</sup> freest in the 2015 Index, the 65<sup>th</sup> freest economy in the world, and the 11<sup>th</sup> out of 41 Asia-Pacific countries.

However, the government still needs to improve macroeconomic conditions, and undertake microeconomic reforms to create a better business climate. They also need to privatize state-owned enterprises, increase trade openness, lower corporate taxes, strengthen regulatory and legal systems, and provide critical physical and social infrastructure. More importantly, the government should create the necessary enabling environment to boost the private business sector, generate economies of scale, boost investment, especially private investment, and spur more core competitiveness to improve productivity.

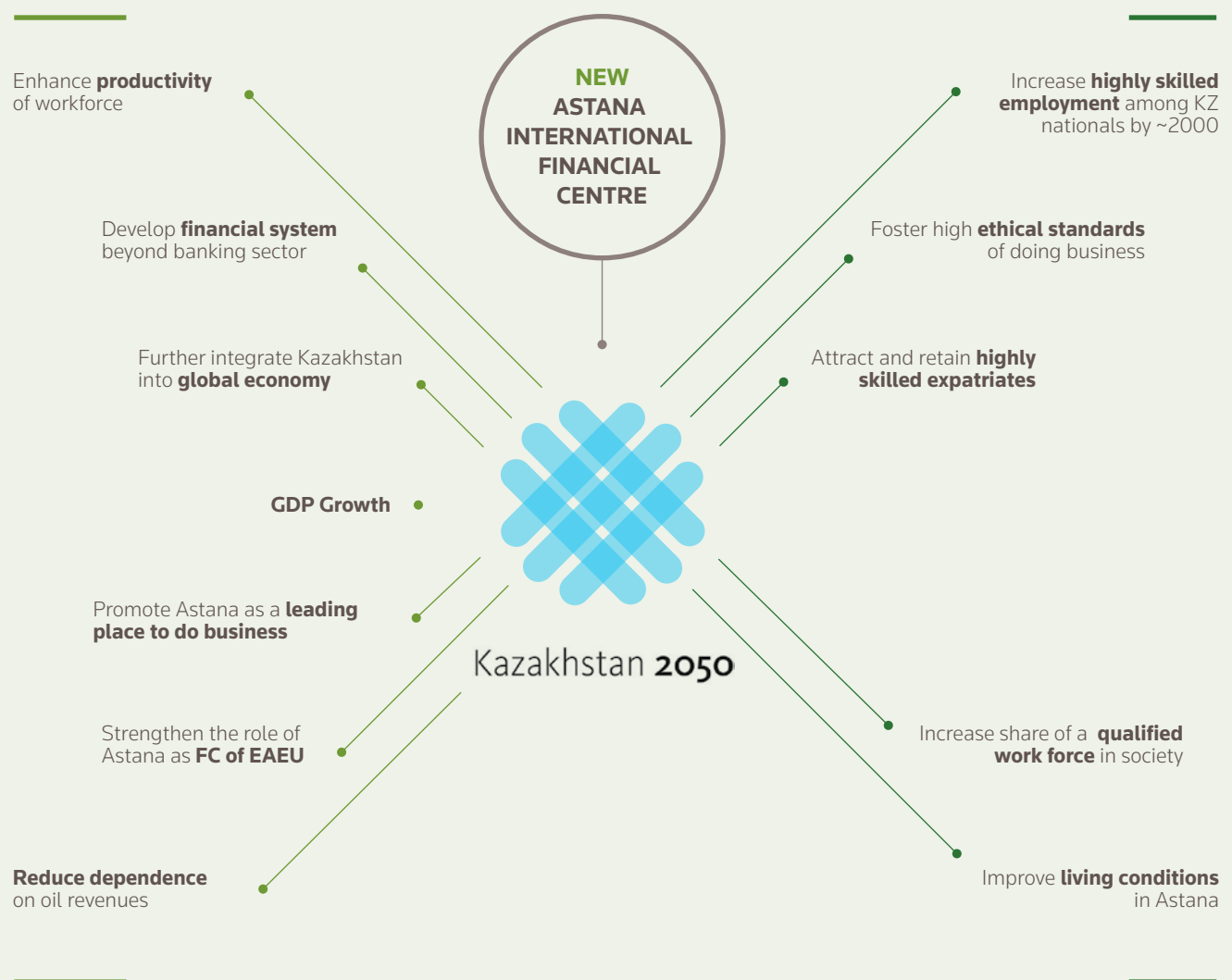


# AIFC — Astana International Financial Centre

VIBRANT FINANCIAL SERVICES SECTOR IN **ASTANA** WILL SUPPORT KAZAKHSTAN'S STRATEGY 2050 ECONOMICALLY AND SOCIALLY

## SUPPORTING KAZAKHSTAN'S ECONOMIC DEVELOPMENT

## SUPPORTING KAZAKHSTAN'S SOCIAL DEVELOPMENT



**DEVELOPMENT OF CAPITAL MARKETS TO START IMMEDIATELY WITH SOLID AMBITIONS SPECIFIC DELIVERABLES OVER THE 10 YEAR HORIZON**

AIFC INSTITUTIONS

01

02

03

04

05

**NATIONAL COUNCIL**

**AIFC AUTHORITY**

**AIFC COMMITTEE**

**AIFC COURTS**

**ARBITRATION CENTRE**

**AIFC 2015 CONCEPT**

Approval of main development pillars  
  
Coordination of the authorities activities  
  
Maintenance of control over the implementation of the project

Developing overall strategy and policies  
  
Promotion of AIFC on global markets  
  
Attraction of potential participants

Financial supervision  
  
Registration and licensing of companies and individuals  
  
Development of rules, regulations

Independent jurisdiction, based on the principles of English Law, different from laws in Kazakhstan

International Arbitration Centre adjudicates in case of arbitration agreement between parties

National Council is the top AIFC executive body led by the President of Kazakhstan

AIFC to be governed by foreign professionals with working experience in financial centres

All placements and trading of stocks is concentrated on one platform – AIFC Stock Exchange

AIFC court judges are granted full independence. Foreign professionals to be brought

Amendments into KZ Constitution to be put enforcing English law within AIFC and independence of judicial system

**BEST PRACTICE**



## BENEFITS OF SETTING UP IN AIFC



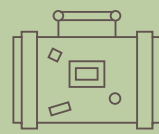
### TAX INCENTIVES

AIFC entities and its staff will enjoy zero taxes for the term of 50 years, on a range of taxes including corporate and individual income, land and property taxes.



### REGISTRATION REGIME

Introduction of a simplified regime for the registration of a “**one-stop-shop**” in the issuance of visas, work permits and other requests on AIFC territory



### VISA REGIME

Visa-free regime up to **30 days** for citizens of member countries of the Organization for Economic Cooperation and Development (OECD), the United Arab Emirates, Malaysia, Monaco and the Republic of Singapore will be introduced. AIFC entities staff will enjoy a special visa regime for a term of up to **5 years**

Source: Original RFCA concept of April 2005, Law on RFCA dated 05 June 2006 (original) and last amended on 21 June 2013; Tax Code; Law on Employment

## CAPITAL MARKETS AND ASSET MANAGEMENT ARE THE 2 KEY PILLARS OF THE ASTANA INTERNATIONAL FINANCIAL CENTRE

### KEY PILLAR DEFINING CRITERIA FOR AIFC

### DEFINITION OF OPPORTUNITY

### DIRECT GDP CONTRIBUTION OF THE PILLAR 2016-25 (US\$ Bn)

### DIRECT JOB CREATION BY 2025 (People)



#### CAPITAL MARKETS

Grow local capital market and increase its liquidity boosting the economic growth and creating a platform, required for all other pillars (AM, PB, IF)



#### ASSET MANAGEMENT

Developing the world class industry of Asset management in Astana leveraging >US\$ 100 Bn asset base of state funds



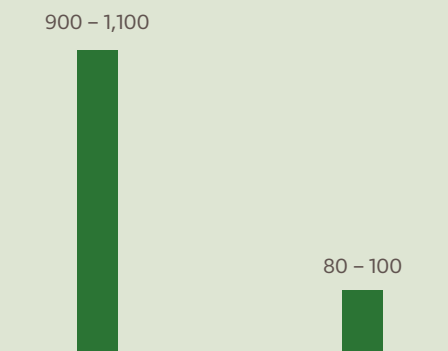
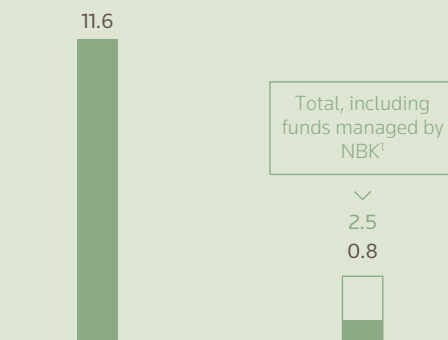
#### PRIVATE BANKING

Developing Private Banking on the back of localisation of foreign AMs starting from advisory, sales and service functions' localisation.



#### ISLAMIC FINANCE

Creating IF market ensuring all elements are in place (baking and capital markets) supported by conventional local and international Islamic banks



### KEY PILLARS

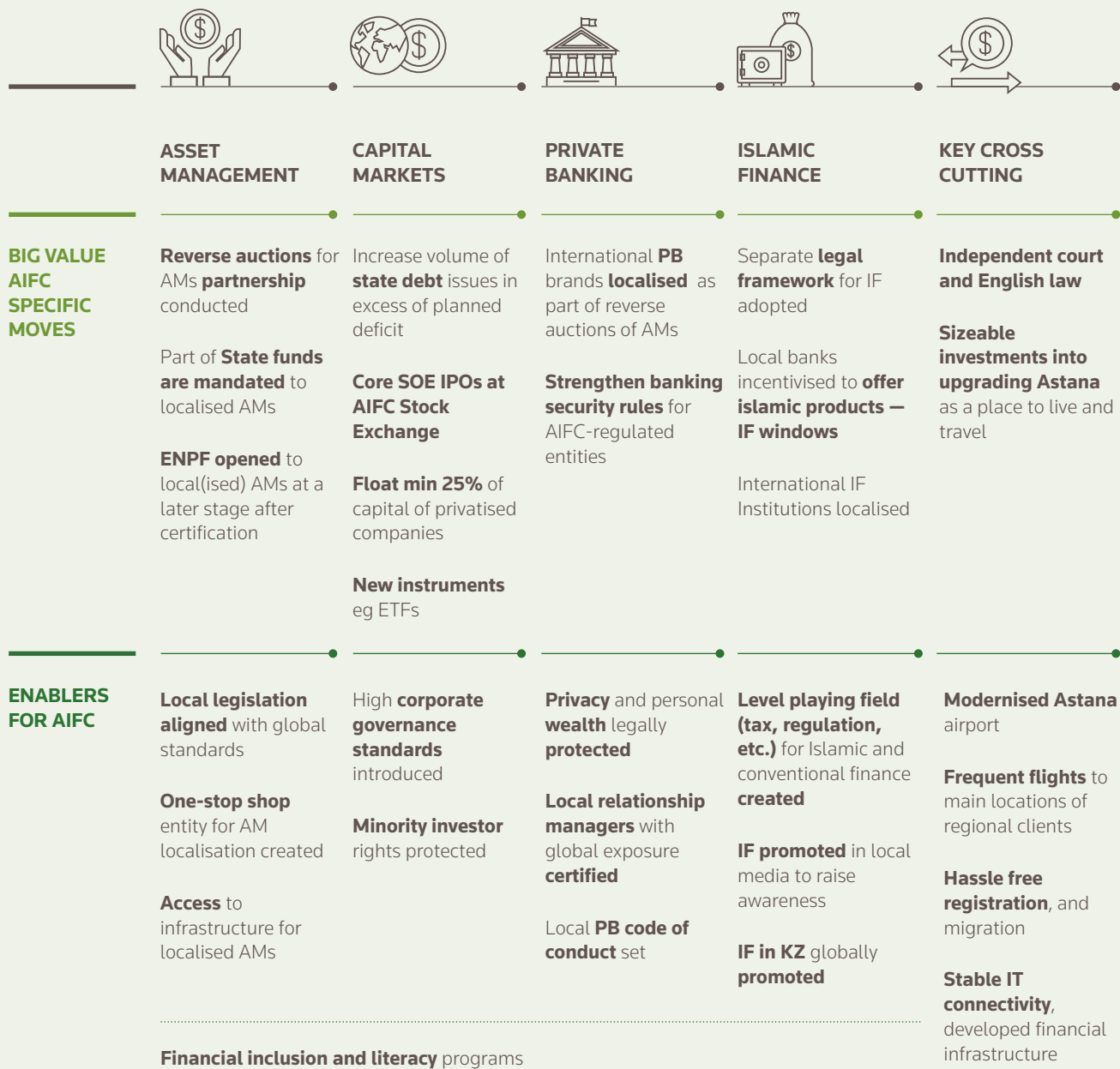
### COMPLIMENTARY PILLARS

1. Funds Managed by NRK are not accounted for as those not creating incremental value and assumed to be part of residual GDP growth  
 2. US\$ 120 Bn out of total fund base 416 by 2025 ie 293 – managed by NBK (majority like today), 100 by foreign AMs out KZ of which ~20 invested in the local CM, 23 by local

Source: National Bank of Kazakhstan, working group analysis

## EFFORTS TO MAKE AIFC HAPPEN GO BEYOND INDIVIDUAL PILLARS

### Key pillar specific and cross cutting enablers



Kazakhstan 2050

➤ For more information visit <https://strategy2050.kz/en/>

## Inflation

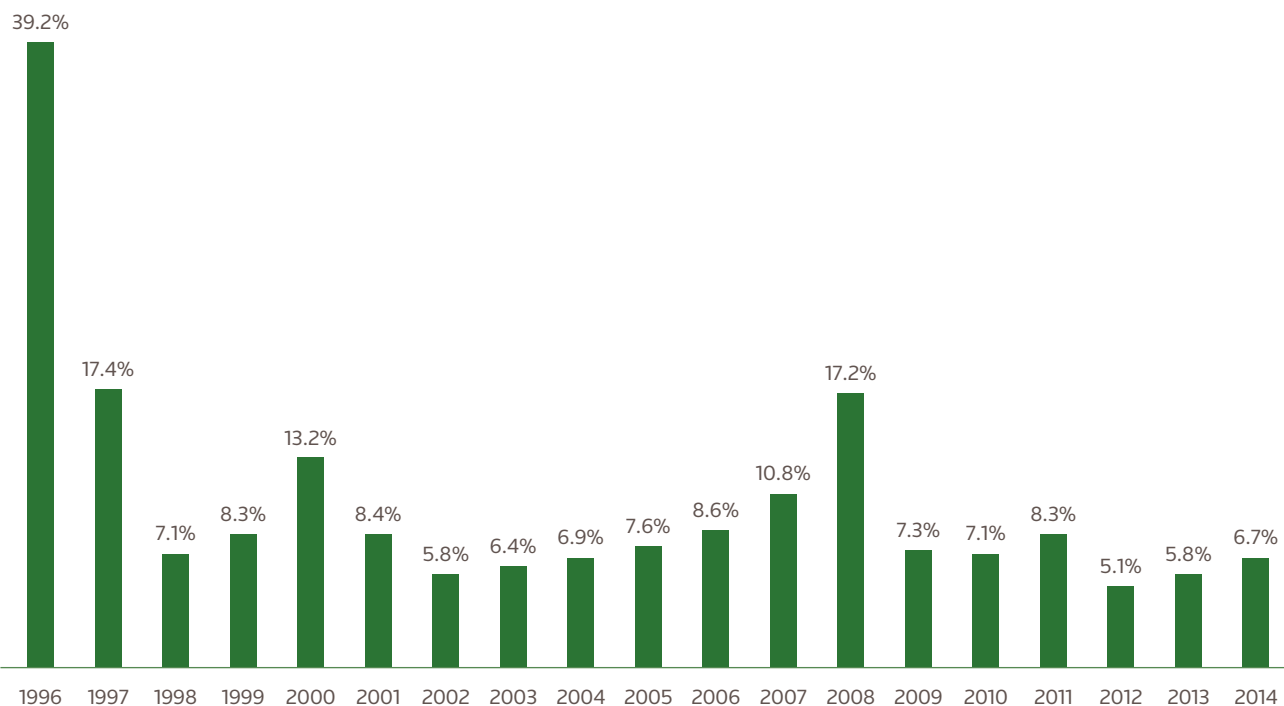
Price liberalization in the early 1990s along with shortages of many commodities pushed prices up. Inflation skyrocketed in 1992 and not until 1996 did it fall below 30 percent. The monetary inflation rate reached 1,381 percent per annum at the end of 1992 and peaked in early 1994 at 1,877 percent.

Until the introduction of the national currency – the *tenge* – on November 15, 1993, Kazakhstan was a member of the ruble zone (in which Russia determined the money supply). After monetary independence, the National Bank of Kazakhstan pursued tight monetary policy and restricted financing of the state's budget deficit, controlled the inflation and stabilized the exchange rate in 1994-1995. Such policy gradually caused a real appreciation of the *tenge* and decreased

price competitiveness of the real sector of the economy. Inflation fell sharply during the global economic downturn, from a very high 17% in 2008 to slightly over 7% in 2009 and 2010, as falling demand and lower commodity prices reduced price pressures. This allowed the National Bank of Kazakhstan to embark on a monetary easing cycle to support the economy.

Inflation is in the single digits but it remains relatively high. In 2011 inflation was out of the Bank of Kazakhstan's target band of 6-8% but it has improved ever since. Among other factors, the high rate in 2011 was a result of the devaluation of the currency against major international currencies. However, with effective monetary policy and low commodity prices, the inflation rate is expected to remain within the target band.

### INFLATION RATE (%), 1996-2014



Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Inflation rate (%)	39.2%	17.4%	7.1%	8.3%	13.2%	8.4%	5.8%	6.4%	6.9%	7.6%	8.6%	10.8%	17.2%	7.3%	7.1%	8.3%	5.1%	5.8%	6.7%

Sources: WDI

## Manageable Fiscal Deficit

Kazakhstan has had good fiscal management and control over the past decade (World Bank 2012a) with public spending stable around 22% of GDP and the non-oil deficit averaging about 3% of GDP. This performance is particularly notable in light of the fact that Kazakhstan experienced significantly increased oil revenues during the period but largely avoided the fiscal pitfalls that have beleaguered so many oil-exporting countries. However, non-oil deficit widened to more than 10% of GDP after the global credit crunch. Kazakhstan in fact created a national oil fund in 2000 to stabilize the economy due to any commodity price swing, in particular, oil price. This fund was also used to development other sectors of the economy to diversify the economy. This fund played a pivotal role after the global crisis in stimulating the economy.

Kazakhstan recorded a Current Account surplus of 2.20 percent of the country's Gross Domestic Product in 2014. Current Account to GDP in Kazakhstan averaged -3.93 percent from 1992 until 2014, reaching an all-time high of 5.42 percent in 2011 and a record low of -51.70 percent in 1992 and -7.97 in 2007. The current account balance further contracted in 2015, because of the unfavorable oil exports (75% of total), associated with production difficulties combined with an adverse evolution of the exchange rate. In addition, lower demand from Kazakhstan's main export markets, the EU, China and Russia, reduced the export, while at the same time imports remained high.

### CURRENT ACCOUNT AS % OF GDP

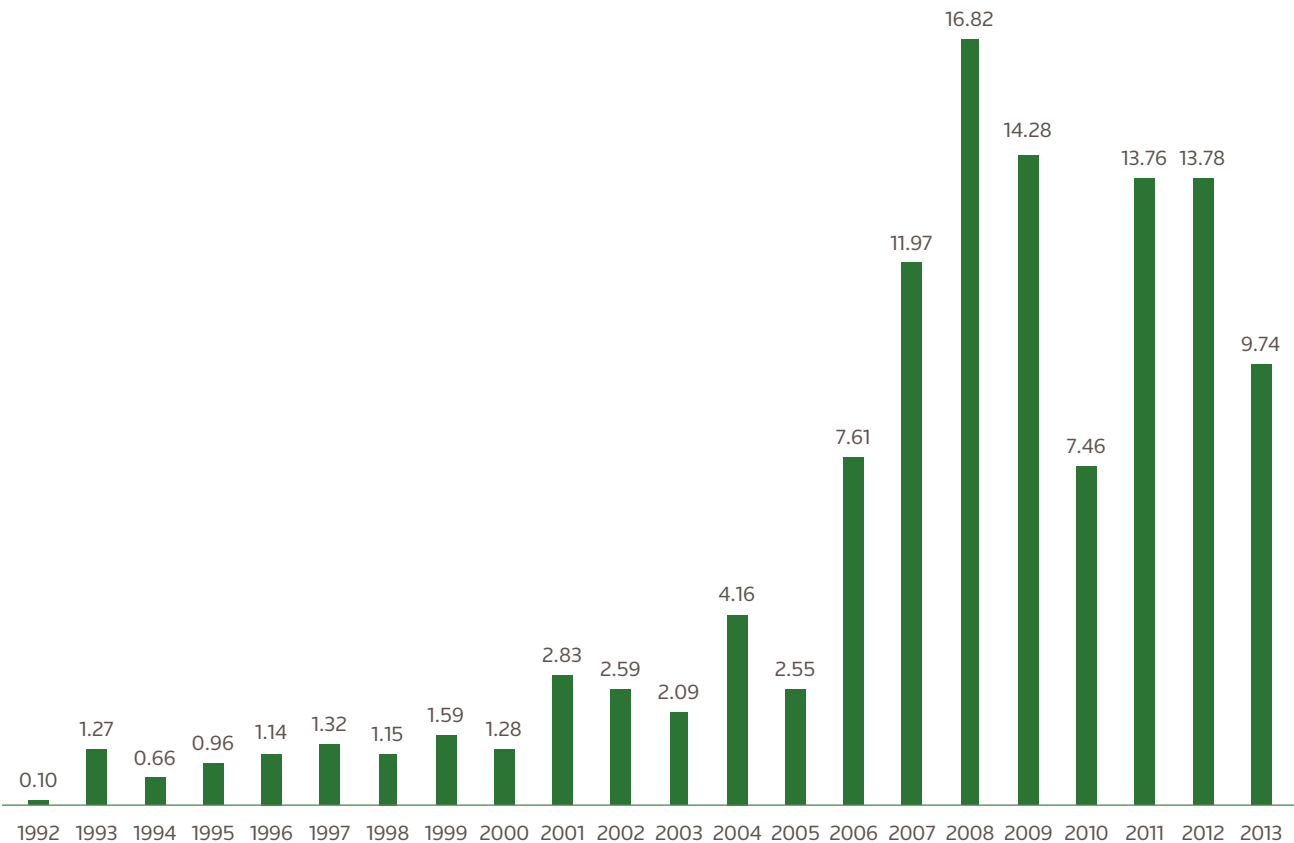


### Strong Foreign Direct Investment

Kazakhstan has made significant progress toward creating a market economy and has achieved considerable results in its efforts to attract foreign investment through a series of reforms to liberalize the economy and facilitate foreign investment. The decade of 1999-2009 witnessed FDI multiplying ten times, increasing from USD 1.852 billion to USD 18.429 billion. This had a dynamic effect on the production of oil and gas. As of December 31, 2013, the total stock of foreign investment in Kazakhstan reached \$209.1 billion. Of that total, net Foreign Direct Investment (FDI) constituted \$129.5 billion, with portfolio and other investments comprising the remaining \$79.6 billion. In a context where global foreign investment decreased by

8% in 2014, FDI flows to transition economies decreased by more than half to USD 45 billion<sup>3</sup>. Regional conflicts, sanctions imposed on Russia and negative growth prospects have deterred foreign investors from the region. FDI continued to flow in and even increased in 2014, despite an overall decrease in FDI in the region. The main investors are the Netherlands, the USA, France, Great Britain and China. The oil and mining sectors are still the most attractive since more than half of the FDI went into these sectors. Foreign Direct Investment in Kazakhstan decreased to 4384.64 USD Million in the first quarter of 2015 from 4735.66 USD Million in the fourth quarter of 2014<sup>4</sup>. Nevertheless, the FDI is still concentrated in the petroleum sector.

FOREIGN DIRECT INVESTMENT (US\$ Bn)





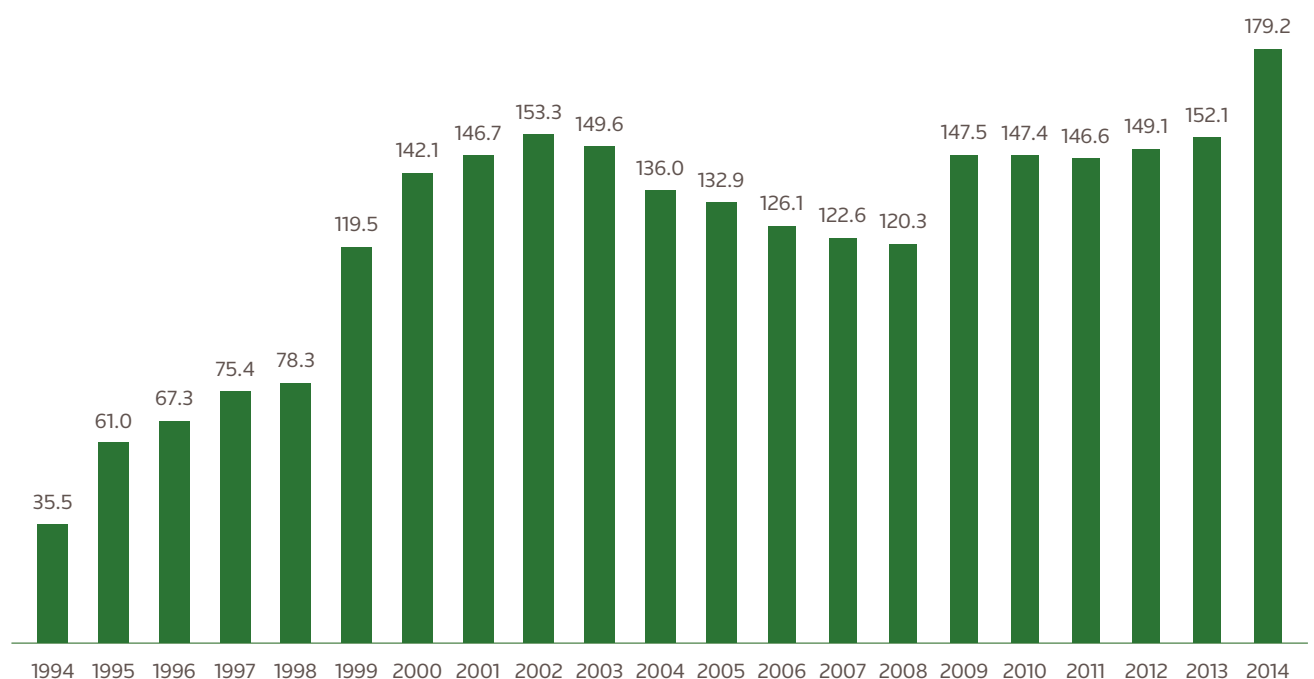
## Financial Service Sector

Kazakhstan emerged as an important financial centre for the CIS region after implementing an impressive range of financial reforms since the mid-1990s. Banking standards and procedures are almost on a par with the international standards. However, a large stock of legacy non-performing loans (NPLs) after global financial crisis currently stands at 23%, and that remains a hindrance on banks' ability to intermediate credit. The authorities have been trying to reduce NPLs to a target of 10% by 2016 through the "Problem Loan Fund" by purchasing bad loans to help banks strengthen their balance sheets. Kazakhstan has created a sound financial system and stable macroeconomic framework. Official policy supports credit allocation on market terms and the further development of legal, regulatory, and accounting systems that are consistent with international norms.

## Foreign Exchange

The National Bank of Kazakhstan (NBK) regulates the national currency by means of a managed floating exchange rate regime. Due to growing speculative pressure on the tenge and other emerging currencies, highly volatile world commodity markets, and the depreciation of the Russian ruble, In February 2014, the NBK devalued the tenge 19% from 155 to 185 to the U.S. dollar. Since this devaluation, the NBK has assured to maintain the tenge at 185 to the U.S. dollar, plus or minus 3 tenge, and promised to pursue policies designed to alleviate sharp fluctuations and short-term volatility of the exchange rate. Although this is the third such devaluation in the past 15 years, the tenge remains generally stable and the government has ample currency reserves to defend it within the designated corridor. More recently, on 26 August 2015, the tenge was pegged at 253 tenge per USD dollar in line with the plans to introduce a freely floating rate of the national currency, not long after the devaluation of Russian Ruble and Chinese currency.

### OFFICIAL EXCHANGE RATE (TENGE/US\$)





“KAZAGRO” NATIONAL MANAGEMENT HOLDING” JSC

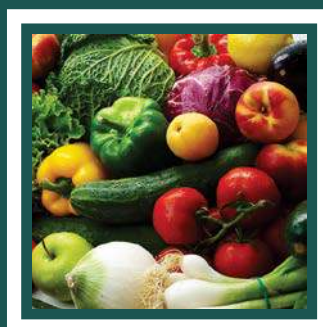


“FUND FOR FINANCIAL SUPPORT OF AGRICULTURE” JSC

## Developing village, we operate future

The programs are implemented within the program “Agribusiness 2020”:

- Funding under the program “Yrys” - the creation and expansion of dairy farms from 50 to 100 head of cattle;
- The program for the creation and development of milk-collection points;
- Program implementation of drip irrigation systems;
- The program is the creation and development of intensive (family) of apple orchards;



The program is implemented by the Road Map 2020:

- Microcredit Program for Employment Program 2020;
- The lending program for the development of single-industry towns;

Islamic finance:

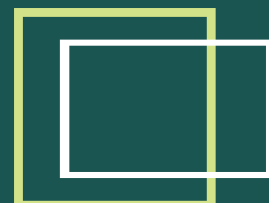
- Microcredit rural and agricultural producers under the “Murabaha”;

Own programs:

- Loans under the program “Kasipker”;
- Lending to agribusiness for spring-field and harvest works on the program “Eginzhay”;
- Loans for the development greenhouses by program “Zhylyzhay”;
- “Crediting of the microcredit (microfinancial) organizations for further microcredit in the village, in mono - and the small cities”;



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## Challenges Ahead

Although the Kazakhstan economy has chalked up robust growth over the years, it faces challenges in maintaining sustainable and inclusive growth. The focus should be on reducing high levels of non-performing loans, diversifying away from the oil sector, reducing the dominant role of the state in the economy, and boosting private sector engagement. In addition, there is also the need for a reform agenda to strengthen human capital and institutions.

The authorities have an overly-ambitious economic growth and development program but they must demonstrate stronger emphasis on structural reforms which should be targeted at improving ease of business, enhancing job creation, and minimizing state intervention in the economy.

A lot more involvement and activities are needed to push regional and global integration. Kazakhstan has started moving in the right direction; it will be joining the Eurasian Economic Union and extending cooperation with the OECD and the European Union, as well as finalised WTO accession in June 2015. Further, Kazakhstan authorities need to increase and strengthen partnerships with multilateral institutions such as the Islamic Development Bank, Asian Development Bank, World Bank, and the International Monetary Fund to improve the country's human capacity in order to meet an increasing need for skilled workers.



THE FOCUS SHOULD BE ON REDUCING HIGH LEVELS OF NON-PERFORMING LOANS, DIVERSIFYING AWAY FROM THE OIL SECTOR, REDUCING THE DOMINANT ROLE OF THE STATE IN THE ECONOMY, AND BOOSTING PRIVATE SECTOR ENGAGEMENT.

# 2 Islamic Finance Overview





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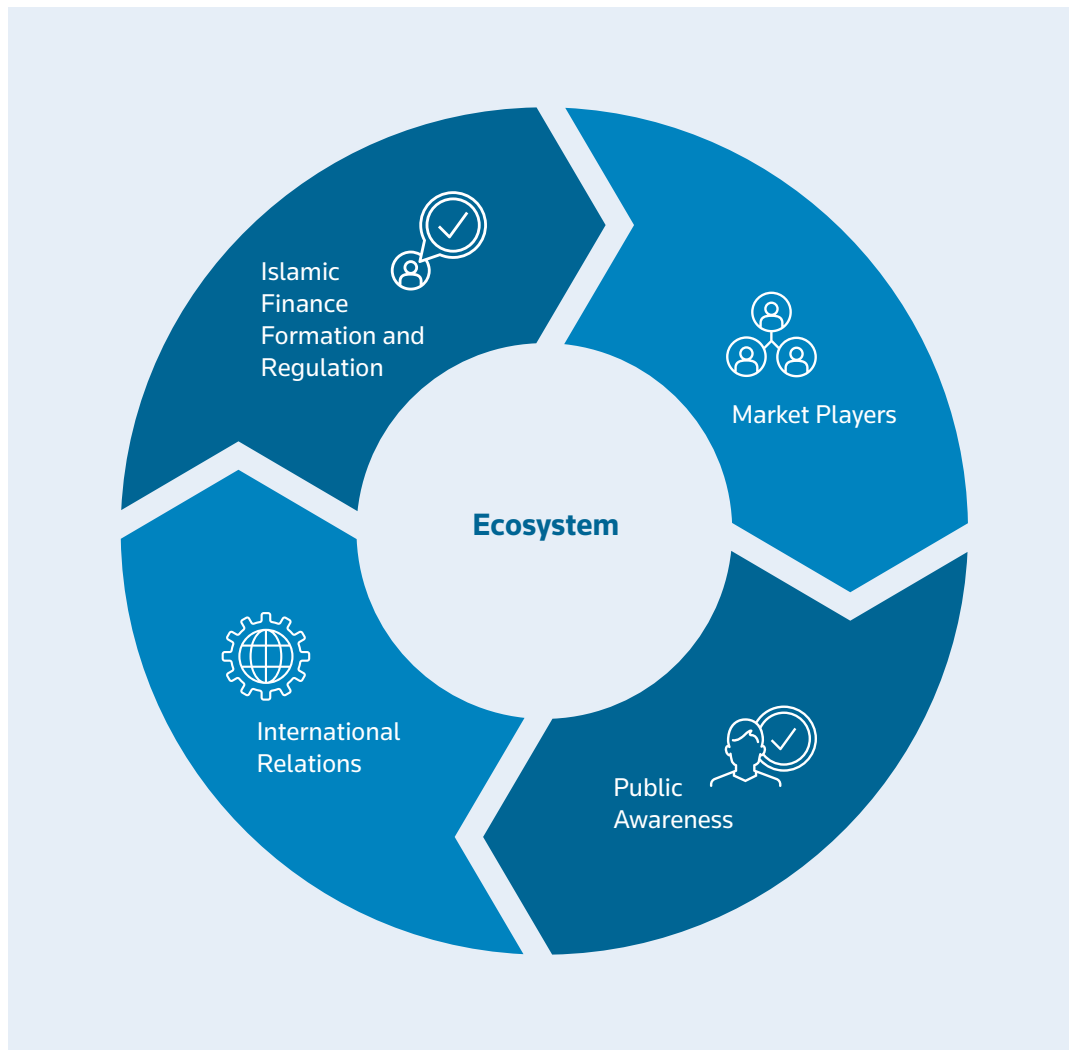
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## Islamic Finance Industry Formation in Kazakhstan



> A hand print of Kazakhstan's President Nursultan Nazarbayev is seen inside the 97-metre monument Baiterek in Astana. REUTERS/Shamil Zhumatov



The emergence of Islamic finance in Kazakhstan can be traced back to the 1990s. In January 1992, Albaraka Kazakhstan was established by the decree No. 5 of the President of the Republic of Kazakhstan. The founder of Albaraka, Sheikh Saleh Kamel, became the first foreign investor of the then newly-sovereign country, investing US\$ 100 mln into the Kazakh economy. In November 1995, Kazakhstan became a member of the Islamic Development Bank and in 1998, the first (and today only) IDB Regional Office across Central Asia and CIS, was opened in Almaty. The IDB began to play an essential role in the introduction and development of Islamic finance in Kazakhstan and the projects and initiatives undertaken by the IDB Group has

allowed the country to overcome some major economic and social challenges.

The next stage of Islamic finance development in Kazakhstan can be characterized as 'a period of precedents': the first Islamic bank, the first issuance of corporate sukuk, the first takaful, ijara and microfinance companies. Despite modest progress, there is potential for substantial development of the industry, backed by political will, financial support from the IDB and initiatives from industry participants. Kazakhstan is also highly regarded as an Islamic investment destination, ranking 5th out of 57 OIC-member countries, according to the Islamic Growth Markets Investment Outlook report published by Thomson Reuters in 2015.



NATIONAL BANK OF KAZAKHSTAN

## H.E. NURLAN KUSSAINOV

Deputy Governor of the National Bank of Kazakhstan



**H.E. NURLAN KUSSAINOV** is the Deputy Governor of National Bank of Kazakhstan since January 2014. He received his Master of Science Management from Stanford Graduate School of Business, Silicon Valley, USA in 2009.

H.E. Kussainov was the Chief Executive Officer (CEO) and Chairman of the Management Board at Development Bank of Kazakhstan from March 2011 to November 2013.

Among H.E. Kussainov's other work experiences were as CEO and Co-founder of Investment Boutique CNRG Capital (January 2007 - June 2009), Head of World Trade Organization Accession Geneva team for the Ministry of Industry and Trade of Kazakhstan (June 2003 - May 2004) and Advisor to the Minister of the Economy and Budget Planning of Kazakhstan (September 2002 - June 2003).

**1. Can you please provide an overview of the current regulatory framework for retail, capital markets and NBFIs. How will the proposed Islamic finance regulation fit into the current regulatory framework? NBK also has other wide ranging mandates such as SWF and Pension Fund. What are the positive or negative implications of such a wide mandate for Islamic finance?**

The National Bank of Kazakhstan (NBK) and other government bodies have launched a joint effort to establish a legal framework for Islamic finance, develop industry infrastructure and increase the level of awareness about Islamic finance among the public.

In 2009, Kazakhstan became the first country in the CIS and Central Asia to introduce legislation for Islamic banking and to create the legal basis for the development of this market segment. In 2011, Kazakhstan's laws and regulations in the field of Islamic finance enjoyed further improvement and establishment of a legal framework for the issue of sovereign Islamic securities, i.e. sukuk.

In addition, this year our legislation has seen further improvement in terms of the creation of a legal framework for Islamic insurance companies (takaful) and the introduction of Islamic leasing operations (ijarah), as well as



expanding the list of authorized Islamic banking products.

Thus, today in Kazakhstan there is a complete alternative to the conventional financial system, with a full regulatory system, which enables us to provide services in the field of Islamic banking, insurance, leasing, funds and issuance of Islamic securities (sukuk).

At the same time, it should be noted that the NBK is a mega regulator of the financial market and uses the same approach to the regulation of both conventional and Islamic financing markets.

Also, we believe that the asset management with regard to the National Fund and the Pension Fund will have a positive impact on the development of such new areas as Islamic finance. In particular, the Pension Fund is the largest holder of the debut issue of the Development Bank of Kazakhstan's corporate sukuk. At the same time, the National Fund purchased Islamic Development Bank's corporate sukuk (US\$100 million).

Thus, the National Fund and the Pension Fund are major potential investors whose presence in the market will stimulate the development of Islamic finance.

**2. Even though it has been a few years since Kazakhstan embarked on adopting Islamic finance, the sector has still not taken off. Why has this been the case? How would you describe the current state of Islamic finance in Kazakhstan? What have been some of the key challenges that have prevented the industry from flourishing?**

Kazakhstan is actively developing an Islamic financial industry in the country. The legal framework has been established, the infrastructure of Islamic finance market is developing, and the first market participants are working successfully.

In 2009 the Association of Islamic Finance Development (ADIF) was established. Its activities are designed to facilitate the comprehensive development of the Islamic finance market in Kazakhstan through active cooperation with Kazakhstan's and international organizations.

Since the establishment of the first Islamic bank, Al Hilal, in 2010, the number of Islamic financial institutions in Kazakhstan has been growing each year. Today, the Islamic leasing company "Ijara", Islamic microfinance company "New Finance", Islamic insurance company "Takaful", and others are operating on the Kazakhstan Islamic finance market.

Under the technical assistance of the Islamic Development Bank (IDB), leading Islamic finance experts were hired in order to further amend Kazakhstan's legal framework and unlock the full potential of Islamic finance in facilitating the economic development of Kazakhstan. Currently, these experts in cooperation with the NBK are analyzing legislation and preparing needed amendments.

But we are fully aware that it is only a small part of what we have to do. It is necessary to solve some problems that prevent the active development of Islamic finance. In this regard, we have defined 3 key initiatives to develop and improve.

**First of all, it is human capital.** We have educated 50 local specialists in the field of Islamic finance, with special grants and assistance being provided by the Government and the NBK. Moreover, we will draw our attention to basic seminars on Islamic finance for the public not only in Astana and Almaty, but also in other regions of our country.

We will continue our collaboration with international organizations, such as IFSB, IRTI, CIBAFI, BIBF, INCEIF and others, not only for hosting seminars but also for the establishment of the Islamic Finance Training Center on the basis of the RFCA Academy, with the help of local state universities. We have a strong commitment to introducing degree programs in the near future.

**The second initiative is to improve legislation** and create an Islamic financial services infrastructure.

We propose to develop Islamic finance step by step. The next step will be the improvement of legislation. To this end, we have signed the Agreement on technical assistance with the Islamic Development Bank.

**Last but not least we also focus on marketing and attracting of Islamic finance market players.**

We are targeting investors from the Middle East and Southeast Asia.

We would like to build Kazakhstan's own model of Islamic finance development. Today, we have all the necessary conditions to develop this industry. So we are open to cooperate with all market players, including those from the Middle East and Southeast Asia.



### **3. What do you see as the potential demand and viability of Islamic finance? What percentage of current and potential business and retail clients will opt for Islamic finance once the Kazakh market is open for Islamic banks? Is there enough information and awareness about Islamic finance in the market? If not, what initiatives do you have planned to address this?**

As you may know, the President of the Republic of Kazakhstan, Nursultan Nazarbayev, has stated Kazakhstan's aim to become a financial center of the new Silk Road. We position Kazakhstan as an Islamic financial hub in the CIS and Central Asia. The region has a combined Muslim population of more than 75 million projected to grow to more than 100 million by the year 2030. In Kazakhstan alone, more than 65%. Of the total population of 17.5 million are Muslims.

This shows a great opportunity for the Islamic financial services industry. Moreover, demand for Islamic financial products will grow because Islamic finance is open to everybody irrespective of religious belief.

It is hard to determine what percentage of current and potential business and retail clients will opt for Islamic finance. This Country Report is the first publication to include a deep research of the market. Therefore, we hope that the Country Report will show us the demand from business and retail clients. However, our expectations are very high.

Human capital and awareness are among the key initiatives to develop and improve Islamic finance. To increase the awareness about

Islamic finance in the market, the National Bank of Kazakhstan in collaboration with IRTI, IFSB, CIBAFI, BIBF and others organised different seminars and training on Islamic finance not only for market players, but also for governmental bodies, mass media, and universities.

### **4. Kazakhstan has been working closely with the regulators of Malaysia, Bahrain and Dubai, etc. What are some of the key lessons that are relevant for Kazakhstan in terms of regulatory framework and government support?**

Kazakhstan would like to build our own model of Islamic finance development. Therefore, we are happy to cooperate with governmental bodies and central banks from the Middle East and Southeast Asia, where Islamic finance has enjoyed double-digit growth.

We collaborate with the regulators in a variety of fields. That is why I would like to mention the main points which we hope to develop in Kazakhstan in drawing on the support of our colleagues from Malaysia, Bahrain and Dubai etc.

The development of Malaysia's Islamic financial services industry has been gradual and structured. The country has the 10-Year Financial Sector Master Plan which contains the main goals and suggestions to develop the industry. The government launched the Malaysia International Islamic Financial Centre (MIFC) to promote Malaysia as a regional hub for Islamic finance. Islamic banking, takaful and the Islamic Capital Market have strong regulatory and legal infrastructure. Moreover, Malaysia has taken steps to build

its capacity by funding research and training institutes (the second highest Islamic finance education provider with over 86 institutions offering Islamic finance education).

Bahrain is one of the leaders in the field of Islamic finance development. The Kingdom hosts key Islamic international financial organisations, such as AAOIFI, International Islamic Financial Market (IIFM), General Counsel for Islamic Banks and Financial Institutions, Islamic International Rating Agency (IIRA), Thomson Reuters Global Islamic Finance Hub and Deloitte's Islamic Finance Knowledge Center. There are quite a few examples of successful conversions of conventional banks into Islamic banks in Bahrain. In 2006, the Waqf fund was established in Bahrain with the support of the Central Bank and financial institutions.

As you may know, the development of the Astana International Financial Centre is being planned along the lines of the Dubai International Finance Centre (DIFC). The DIFC will share its experiences and expertise for setting up the financial center, including the Islamic financial hub, at Astana in Kazakhstan. The DIFC has gone on to become a major player in the international arena and competes directly with leading financial centers such as London, New York, Hong Kong, Singapore and others. We are looking forward to gaining some valuable insights from the DIFC.

### **5. What do you see as the regulatory road-map to facilitate Islamic finance to reach a level playing field with conventional players? What are the possible scenarios?**

In order to develop the Islamic finance industry, on 29th March 2012, the Government of the Republic of Kazakhstan approved the Islamic finance development road-map 2020. This program determines the directions and procedures to be taken by governmental bodies and businesses to achieve the mutual objectives, by creating conditions for the stable development of the Islamic finance industry, promoting the establishment of new Islamic banks, Islamic securities issuers, investors, and market participants.

As mentioned, Kazakhstan has established the legal framework for the organization of Islamic banks, Islamic investment funds, Islamic insurance and leasing companies, involving the Islamic capital market, which would enable Islamic securities to be issued. Tax legislation has been amended to create a level playing field vis-à-vis conventional players in terms of tax neutrality at the application of the pro-rata method of VAT offset for the customers of Islamic banks.

In line with the above initiatives, the following steps for the further development of Islamic finance in Kazakhstan are planned:

- Implementation of the Islamic finance development road-map 2020;
- Issuance of sovereign sukuk by the Ministry of Finance of Kazakhstan in order to create a benchmark for the issuance of corporate sukuk;
- Further enhancement of the legislation relating to the Islamic finance areas including the implementation of “Islamic windows”, adoption of the conversion of con-

ventional banks to become Islamic banks, and guarantee of customer deposits of Islamic banks;

- Attraction of new market players (promotion of Islamic banks to be opened, Islamic insurance (takaful) companies, Islamic investment funds, leasing and consulting companies, etc);
- Strengthening of international cooperation for the further development of Islamic finance and banking in Kazakhstan (hosting of forums, conferences, workshops, seminars, etc).

#### **6. What would be your desired share of Islamic banking assets for Kazakhstan’s total banking sector in 2020 and 2030?**

The Conception for the Development of the Financial Sector of the Republic of Kazakhstan till 2030 has established the forecasting and target indicators for the development of Islamic banking, namely the share of Islamic banks in 2020 is to grow up to 3-5% of the total assets of the banking system of. In this regard, we will work to increase the share of Islamic banking to reach our goals.

We have to do it step by step and be fully cognizant of where we are heading. For example, Malaysia and Turkey have been developing Islamic finance for 30 years and Islamic banking assets as a percentage of the overall banking sector in these countries account for 20% in Malaysia and 5% in Turkey . The Islamic banking sector in Indonesia is also around 5% and they started Islamic finance development in 1990.



**HUMAN CAPITAL AND AWARENESS ARE AMONG THE KEY INITIATIVES TO DEVELOP AND IMPROVE ISLAMIC FINANCE. TO INCREASE THE AWARENESS ABOUT ISLAMIC FINANCE IN THE MARKET, THE NATIONAL BANK OF KAZAKHSTAN IN COLLABORATION WITH IRTI, IFSB, CIBAFI, BIBF AND OTHERS ORGANISED DIFFERENT SEMINARS AND TRAINING ON ISLAMIC FINANCE NOT ONLY FOR MARKET PLAYERS, BUT ALSO FOR GOVERNMENTAL BODIES, MASS MEDIA, AND UNIVERSITIES.**



## **7. What is the status of the formation of the Central Sharia Committee Board and the Sharia regulatory framework? Do you have the initial list of the scholars? Are they Kazakhs or foreigners?**

An important condition for the operations of an Islamic financial institution lies in its compliance with the principles of Islamic finance. Therefore, the current legislation of the Republic of Kazakhstan strictly demands that all Islamic financial institutions have to form the Council for Islamic financing principles (CIFP), or better known as the Shariah Supervisory Board.

The NBK team is studying the experience of the operations of Shariah Supervisory Boards globally, their functions and requirements for members, as well as considering the possibility of creating a central CIFP in Kazakhstan.

But it is necessary to note that, according to the legislation of Kazakhstan, the central CIFP cannot be created within a governmental body, as the issues of supervision over the observance of Shariah for financial transactions cannot be included into the functions of the Government, including the National Bank.

In this regard, owing to the lack of a sufficient number of market participants in Islamic banking and finance in Kazakhstan to date, the NBK recommends to consider the possibility of creating a central CIFP as a consultative body within the Association of Development of Islamic Finance (ADIF) as an organization which has been established for the development of the Islamic financial market and representing market

participants' interests in the Republic of Kazakhstan.

Thereby, the ADIF has recently established the Expert Council responsible for Shariah legal issues faced by members of the association.

The Expert Council consists of foreign and local experts, such as the head of the Shariah Advisory Council of the central bank of Malaysia, Dr. Mohammad Daud Bakar, Kazakh Shariah graduate Maksatbek Kairgaliev, and holder of a Master's degree in Islamic jurisprudence, Magomed Gazimagomedov. The ADIF has signed an agreement with the Shariyah Review Bureau from Saudi Arabia, which specializes in Shariah advisory and Islamic law. It has been negotiated as well that it would be possible to include one of the most recognized Shariah experts, Sheikh Muhammad Taqi Usmani, into the Expert Council.

In addition, there is already an operational CIFP created within Al Hilal Bank Islamic Bank in Kazakhstan. The members of this CIFP are well-known Shariah advisors such as Shaikh Dr. Abdussattar Abu Ghuddah, Shaikh Dr. Nizam Yaquby, and Shaikh Esam Mohammed Ishaq.

## **8. As "salam" is the most commonly used contract to finance agricultural projects and as Kazakhstan has a significant agricultural sector, the new draft law for Islamic banking should facilitate the offering of salam-based products. Are "salam" and "istisna" part of the revised draft law?**

As mentioned before, the NBK, with technical assistance from the IDB has been using a grant for the enhancement of legislation on

Islamic finance in Kazakhstan. One of the assigned tasks is to implement a set of new products and financing mechanisms that may have the potential for widespread use by market participants.

In this regard, the NBK invites legal experts to improve the legislation with regard to Islamic finance. Thus, the international consulting firm Norton Rose Fulbright, which has extensive experience in providing similar services, is preparing a report, which will include a number of proposals to introduce new types of products and services for Islamic finance, including products based on contracts of "salam" and "istisna" as well.

## **9. Are there any international banks that have applied for Islamic banking licenses? From which countries? How does Kazakhstan plan to deal with local versus foreign players?**

Currently, Kazakhstan has one Islamic bank which is a subsidiary of Al Hilal Bank with its headquarters in Abu Dhabi (UAE). Moreover, at present, one of Kazakhstan's conventional banks, in cooperation with the Islamic Corporation for the Development of the Private Sector (ICD), is preparing to start the process of conversion to become an Islamic bank. It will start the conversion process after the adoption of the relevant amendments. Currently they are under discussion in the parliament.

Large banking groups such as Al Baraka and MayBank are showing interest in our market. In general, I would like to state that we will encourage the localization of international Islamic banks in Kazakhstan.



At the same time, we plan to encourage local banks to provide Islamic banking services by offering favorable conditions.

### **10. When do you expect the revised Islamic banking law to become fully effective?**

In 2009 and further in this year, Kazakhstan was adopting laws on Islamic banking. The adopted amendments fully regulate the activity of an Islamic bank. At the same time, we are introducing appropriate amendments where necessary. For example, the National Bank has prepared the amendments on the conversion of a conventional bank to become an Islamic bank, which are planned to enter into force by 1st January 2016.

### **11. We understand that unlike Oman, where new entrants into Islamic banking are banned from operating windows, Kazakhstan plans to allow Islamic windows. What is the rationale behind this decision and what are the results you expect?**

The Islamic Banking and Finance Law which was introduced in 2009 was mostly conservative and excluded Islamic windows in conventional banks. However, over time, awareness has been growing and it is difficult to develop the Islamic finance industry without Islamic windows. It should be noted that the rapid development of this industry in such countries as Malaysia and the UK also started on the basis of Islamic windows. As mentioned earlier, the National Bank, in cooperation with the law firm Norton Rose, are preparing a draft Law on Islamic Finance, which, we expect, will also include global best practices in the field of Islamic

banking and Islamic windows. The introduction of Islamic windows will help us diversify the sources of funding for banks, and create additional banking products to customers, including retail.

### **12. The government has decided to position Astana instead of Almaty as the regional hub for Islamic finance. What are the reasons behind this? What incentives are being planned to give Astana the necessary boost to take off as a regional hub of Islamic finance?**

The development of Astana International Financial Centre as a regional hub of Islamic finance should also be based on Islamic finance and sovereign sukuk issuance. It will stimulate the inflow of Islamic capital into the country and develop the Islamic banking sector alongside the conventional one.

We are planning a sukuk issuance, attracting international Islamic financial organizations to AIFC, introducing Islamic windows, converting conventional banks to become Islamic, and introduce insurance for Islamic deposits. Moreover, a reduction of capital requirements for of Islamic banks has been proposed – from 10 billion tenge to 5 billion tenge for foreign and local investors. All of these measures will help promote Astana as a regional hub of Islamic finance and boost the share of Islamic banking assets up to 3-5% of the country's total banking assets.

### **13. What are Kazakhstan's ambitions in terms of kickstarting the sukuk market? Is this going to be primarily driven by sovereign and quasi sovereign issues? What**

### **are the plans and incentives to encourage corporate sukuk?**

In 2011 Kazakhstan was the first in the region to adopt laws which make it possible to issue sukuk: Islamic lease certificates and Islamic participation certificates, issuance of sovereign Islamic securities. The list of corporate issuers of Islamic securities has been expanded, too.

In July 2012, the Development Bank of Kazakhstan became the first issuer in the region to successfully issue a sukuk (sukuk al-murabaha) amounting to US\$76.7 million. 62% of the issue was distributed among foreign investors.

In addition, in October 2014, the Ministry of Finance of the Republic of Kazakhstan, after a 14-year break, sold Eurobonds totalling US\$2.5 billion. Investors have shown a very high interest in Kazakhstan's sovereign Eurobonds as total book claims exceeded US\$11 billion. Following the success of the 2014 Eurobond, the Ministry of Finance tapped the bonds market again in 2015, issuing another Eurobond for an amount of US\$ 1.5 billion with 30-year maturity to finance the budget deficit of the country.

Due to such high investor demand for the 2014 and 2015 Eurobonds, we anticipate healthy investor interest if the government issues sovereign or quasi-sovereign sukuk in the year 2016.

### **14. The uptake of takaful has been the slowest of all Islamic finance segments even in developed Islamic markets. How does Kazakhstan intend to promote the development of a vibrant takaful industry?**



WE CAN SAY WITH CONFIDENCE  
THAT TO DATE WE HAVE PUT IN PLACE  
ALL NECESSARY CONDITIONS FOR  
THE FULL DEVELOPMENT OF  
THE WHOLE INFRASTRUCTURE  
AS WELL AS TO ATTRACT  
INVESTMENTS INTO OUR COUNTRY.

For the full development of the whole industry, there is a need to develop all segments. We cannot consider Islamic banking development without takaful development, as well as takaful development without capital market development.

We adopted the first Islamic finance law in 2009 but the issues of Islamic insurance were not considered. In spite of this, in 2010 the first Islamic insurance company was established in Kazakhstan in the form of a mutual insurance company and attracted a number of customers. Given the trend of the industry and the need for development of the infrastructure, we have developed a draft law considering the introduction of Islamic insurance in the country. On the 27<sup>th</sup> of April, 2015 the President signed the law, according to which we can introduce Islamic insurance based on two models: wakalah and mudarabah.

According to ICD Thomson Reuters Islamic Finance Development Report 2014 Kazakhstan is ranked 5<sup>th</sup> on the legislative consolidation of all segments of the Islamic financial system. It should be noted

that at the time when the report was being prepared, we did not have any legislation in the field of Islamic insurance.

The adoption of the Law would give a new impetus to the development of Islamic finance in Kazakhstan and consolidate the country's status as a regional hub for Islamic finance.

So we can say with confidence that to date we have put in place all necessary conditions for the full development of the whole infrastructure as well as to attract investments into our country.

**15. What ambitions does Astana have in terms of Islamic finance especially in light of the regional integration/customs union? How do you view competition from other regional hubs such as Kazan and potentially Moscow?**

The geopolitical position of Kazakhstan has all the prerequisites to develop the AIFC as the main centre of attraction for foreign capital in the CIS. We realize that the AIFC is not a competitor for other regional hubs such as Kazan and potentially Moscow. We are

ready to help them. Moreover, Kazakhstan already shares its own experience in the field of Islamic financial services industry. Recently, our colleagues from CIS countries participated in the Certified Islamic Banker qualification seminar and IFSB Summit, which was hosted by the National Bank of Kazakhstan. In addition, by the year 2025, a single financial regulator of the Eurasian Economic Union will have been set up in Astana.

# The Development of Islamic Finance in Kazakhstan

- **Kazakhstan is the first of the CIS countries to** adopt a special legal framework for Islamic finance.
- **The Association for Development of Islamic Finance (ADIF)** was established.

2009

- **The 7<sup>th</sup> World Islamic Economic Forum (WIEF)** was held in Astana.
- To facilitate **Sukuk** market development and expand potential domestic originators list, **a set of new amendments** to the legislation was adopted.

2011

2010

- **AlHital Islamic Bank** started to operate as a full-fledged Islamic bank under intergovernmental agreement between Kazakhstan and UAE.
- **Takaful**, the first Islamic insurance company in Kazakhstan was established as a Mutual Insurance Society.

2012

- **The Road Map for Islamic Finance Development** in Kazakhstan by 2020' was approved by the Government
- **The Member Country Partnership Strategy** 2012-2014 was signed by the Government of Kazakhstan and IDB Group
- **The Development Bank of Kazakhstan** issued the first Sukuk to the amount of US\$ 76.7 Mn.
- The National Bank of Kazakhstan became a Member of IFSB.



- Islamic Corporation for the Development of the Private Sector (ICD) acquired shares in the capital of local bank 'Zaman Bank'. The shareholders of **Zaman Bank** have been trying to convert it to become the country's first retail Islamic bank.
- ICD and a group of international and local investors established the first **Kazakhstan Ijara Company**.

2013

- The **Memorandum of the Long-Term Cooperation** between the National Bank of Kazakhstan and the Association for Development of Islamic Finance was signed in February 2015.
- Relevant legal provisions to improve conditions for Islamic banking operations and to include **Islamic Insurance and Leasing** into the legislation came into force in May 2015.
- The **12<sup>th</sup> Summit of IFSB** was held in Almaty in May 2015.
- Kazakhstan plans to issue **Sovereign Sukuk** in 2016.
- Relevant legal provisions to allow conventional banks to be converted into Islamic banks.

2015

- **The Fund for Financial Supporting of Agriculture** launched the **Murabahah** Program for Islamic Microfinance under the agreement between the IDB and the Fund.
- The National Bank of Kazakhstan established a new Department for **Development of the Regional Financial Centre of Almaty City and Islamic Finance**.

2014

- The National Bank of Kazakhstan received **Technical Assistance from IDB to review and develop Islamic finance legislation in Kazakhstan**. Norton Rose Fulbright was selected within the framework of this technical assistance to execute the project.
- **N. Nazarbayev**, the President of Kazakhstan, was awarded the Global Islamic Finance Award (GIFA).
- The National Bank of Kazakhstan became an Observer Member of **AAOIFI** and an Observer Member of **IIFM**.



▲ Youths performing during an election campaign rally of Kazakhstan's President and presidential candidate Nursultan Nazarbayev sit behind national flags at a stadium in Almaty. REUTERS/ Shamil Zhumatov

The government is keen to make Kazakhstan the regional hub of Islamic banking for the CIS and Central Asia by 2020. As it stands, Almaty is well-placed among Asian financial centres, ranking 12<sup>th</sup>, according to the Global Financial Centres Index. This ambition was formalised by the President in 2015 by the signing of the decree which set up the framework for the establishment the Astana International Financial Center (AIFC) as a special financial zone with its own judicial system based on English law and with Islamic finance as one of two main pillars. The AIFC Decree includes the directive for the National Bank of Kazakhstan to create conditions for the issuance of sovereign Islamic securities.

The key functions of the AIFC is to develop the local capital markets through issuing government treasury bonds, conducting IPOs for governmental entities and activating the Unified Accumulative Pension Fund (UAPF) in the secondary market, mainly to grant mandates to the foreign management companies based in the country. The AIFC is also mandated to develop the asset management industry, as the number of asset management companies has dropped significantly since 2007 due to the dominating position of the state and underdeveloped retail sector. In addition, the development of the Islamic finance industry is also a key focus area for AIFC. The key developments are in the area of attracting foreign players into the country, the issuance of sukuk, the introduction of Islamic windows, and the conversion of conventional banks to Islamic.

The authorities in Kazakhstan (i.e. the President, Government, and the National Bank of Kazakhstan) consider the development of the Islamic finance industry as a way of diversifying financial services in the country and as a condition for attracting investors from the Middle East and Southeast Asia. The National Bank of Kazakhstan is taking steps to establish a level playing field for Islamic financial intuitions. For example, in order to ensure the equal treatment for both Islamic and conventional financial products, special legal provisions were introduced in the Tax Code.

However, it should be pointed out that the Regulator does not aim to provide special incentives for Islamic finance in the country. This differentiates Kazakhstan's model of Islamic finance from the Malaysian one, for example, where the state provides impetus in the form of financial, tax, and regulated incentives, and dominates via its agencies. For instance, to make sukuk more competitive, Malaysian authorities provide tax incentives. The Islamic finance industry is protected in Malaysia as an "infant industry".

The Islamic finance model in Kazakhstan has some similarities with the UK model. The key principle adopted by the British government towards the formation of its Islamic finance industry is "no obstacles, no special favours". The UK government aimed to set up equal conditions for all participants of the UK's financial markets. The government recognised that everyone would benefit from the UK becoming a global centre for Islamic finance through increased tax receipts, private spending and economic activity that flow from the financial services industry.

The British authorities amended tax and regulatory guidelines with the aim of establishing a level playing field for Islamic financial institutions. This approach has strengthened the role

of Islamic finance in the UK towards achieving strong and sustainable economic growth.

At the same time, the UK's Financial Conduct Authority (FCA) noted that the establishment of a special legal field for individual financial institutions was unreasonable and legally impossible. For example, according to Shariah norms income cannot be guaranteed by an Islamic bank and moreover, there is a risk to lose capital.

However, the FCA makes it mandatory for all banks that accept deposits to follow the Deposit Guarantee Scheme. This approach sets apart the UK's regulations for Islamic finance from the Kazakh one.

According to the Bank Law of the Republic of Kazakhstan, the Islamic bank is not a participant of the deposits obligatory insurance system, and deposits in Islamic banks are not guaranteed by the deposits obligatory insurance system. Given this provision, *ceteris paribus*, deposits in Islamic banks are less attractive than if they were deposited in conventional banks. Addressing this issue, the National Bank of Kazakhstan is working to develop a special deposit insurance system based on the world best practices.

## The development of Kazakhstan Islamic banking law



The National Bank of Kazakhstan (NBK) added Islamic finance regulations in 2009 to its existing framework to cover Islamic banking, takaful, retakaful, and sukuk.

The 2009 Islamic banking laws were designed to pave the way for new Islamic banks.

The sukuk law was adopted in July 2011 to allow sukuk issuances. The law allows the government and all legal entities registered in Kazakhstan to issue sukuk. The law also allows the trading of sukuk in the secondary market; however, the market has only seen one government sukuk issuance to date.

Nonetheless, the outlook remains positive, and the second sukuk issuance could be just around the corner as the government is considering issuing the first sovereign sukuk in early 2016 by the Ministry of Finance. The government announced that it would use a sovereign sukuk, or loan at the end of 2014, but with the recent developments in Islamic finance space in Kazakhstan, it is expected that the government to issue a sukuk. Kazakhstan could well capitalise on the demand and attract a large investor base to the country given the shortage in sukuk supply in global markets.

A law was also passed to include Islamic funds under the umbrella of the Islamic finance laws.

Under the 2009 Islamic banking law, the country was only able to see the establishment of one full-fledged Islamic bank, Abu Dhabi-based Al Hilal Islamic Bank, which started operating in the country in 2010. It is clear that the 2009 law had failed to attract and stimulate Islamic banking activities. As a result, the regulators have re-worked the Islamic banking law and a new unified law has been signed by the pres-

ident. It will focus on a certain set of financial instruments in addition to introducing new structures and mechanisms the industry has to offer. The drafting of the new Islamic banking law has been in progress since 2014, and was finalized in April, 2015.

According to the existing legislation, conventional banks still cannot be converted to become Islamic banks. In order to convert, a conventional bank should completely shut down and reapply for an Islamic bank licence to be able to become Shariah-compliant, a process that could take as long as three years. Accordingly, the National Bank prepared the necessary amendments which would allow conventional banks to be converted into Islamic banks. According to the Law which was adopted in November 2015, conventional banks can be converted to become Islamic banks.

### Further amendment in the Law by end of 2015

The National Bank of Kazakhstan is adopting a step-by-step process to amend its laws instead of "in one go". The regulator plans to make further amendments by end of 2015 to the recently approved law in April 2015 to allow conversion of conventional banks to become Islamic. In addition, to further develop the Islamic banking sector, the governor said in an exclusive interview with Thomson Reuters that a new proposal is being drafted to reduce the requirements for capital of Islamic banks from 10 billion tenge to 5 billion tenge for foreign and local investors. The government is aiming to increase the Islamic banking share to 3-5% by 2020.

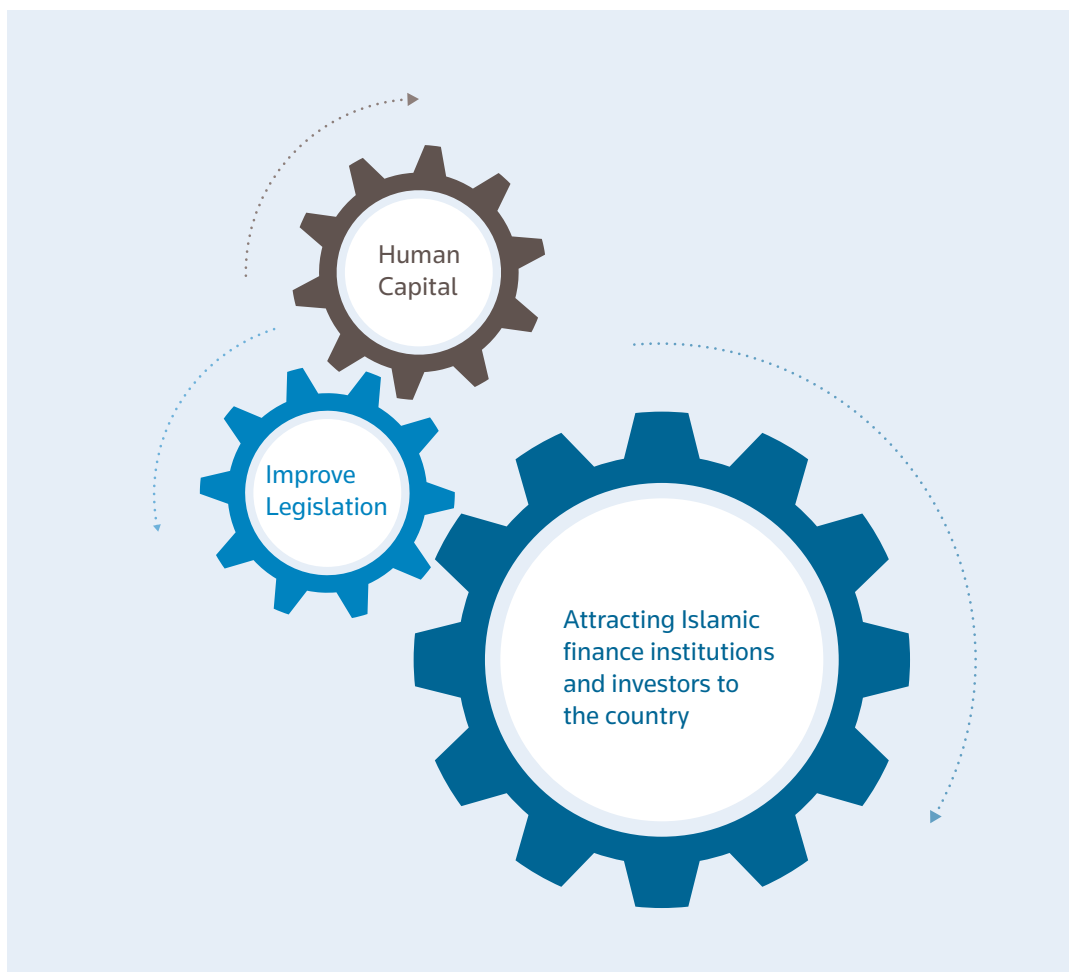
The NBK is also taking other measures to tackle some of the challenges to spur development in its Islamic finance sector. The NBK prepared a blueprint to mainly target three areas. Firstly,

the government is working on its human capital given the lack of expertise, through education to continue spreading awareness through conducting basic Islamic finance seminars across the country. Secondly, the NBK is working to improve its legislation and to create Islamic financial services infrastructure, which is going to be also through a technical assistance with Islamic Development Bank. Last but not least, is to attract Islamic finance players such as institutions and investors from the Middle East and Southeast Asia as the new law by end of 2015 is expected to pave the way for more FDI.

Another challenge that was hindering the growth of Islamic banks under the previous law was the divergence of tax treatments for Islamic banks compared to commercial banks (commercial banks are known as Tier 2 banks), as the law did not entitle Islamic banks analogous tax privileges

that conventional banks enjoy. The law has now been amended to treat all Tier 2 banks equally, which is a positive move towards encouraging more Islamic banks.

It is worth noting that Kazakhstan law does not include any Arabic terminology of Islamic finance such as *riba*, *musharakah*, *ijarah*, *takaful*, *Shariah*, etc. Only the term “Islamic”, together with the descriptions of Islamic financial products, are used in the Law to identify Islamic modes of financing. This is a unique approach among secular states which keeps connections with the nature and principles of Islamic finance, and at the same time this approach places emphasis on the substance of the products through their definitions. Basic transactions of Islamic banks as well some other definitions pertaining to Islamic financing in Kazakhstan Law is illustrated in the next table.



## Islamic finance terminology in Kazakhstan Law

Traditional terminology	Definition in Kazakhstan Law
<b>BANK LAW</b>	
<b>Accounts based on <i>qard hassan</i> principles</b>	Accepting interest-free demand deposits from individuals and entities, opening and maintaining their bank accounts
<b>Accounts based on <i>murabahah</i> principles</b>	Accepting investment deposits from individuals and entities
<b>Financing based on <i>qard hassan</i> principles</b>	Bank borrowing: providing interest-free cash loans repayable within specified periods
<b>Financing based on:</b> <ul style="list-style-type: none"> <li>■ <i>murabahah</i> principles</li> <li>■ commodity <i>murabahah</i> principles</li> </ul>	Financing of individuals and entities as a commercial agent by providing a commercial loan; <ul style="list-style-type: none"> <li>■ without the right to resell the commodity to a third party</li> <li>■ with the right to resell the commodity to a third party</li> </ul>
<b>Financing based on <i>mudarabah</i> and <i>musharakah</i> principles</b>	Financing manufacturing and trading activities through equity participation and/or on partnership conditions
<b>Financing based on <i>ijarah</i> principles</b>	Investment activities on leasing/renting conditions
<b>Transactions based on <i>wakalah</i> principles</b>	Agency for Islamic bank's banking transaction
<b>Shariah Supervisory Board</b>	Council on Islamic Financing Principles
<b>SECURITY LAW</b>	
<b>Sukuk</b>	Islamic Securities shall mean securities issued in accordance with the Islamic Financing Policies and certifying the title to an undivided share, tangible assets and/or revenues thereon, services provided under, or assets allocated to, specific projects to be financed for account of such securities
<b>INSURANCE LAW</b>	
<b>Takaful fund</b>	Islamic insurance fund is formed by an Islamic insurance (reinsurance) company out of insurance premiums on Islamic insurance agreements as well as out of other incomes received as a result of their investment activity with the aim of settling insurances claims on Islamic insurance agreements

## The main principle of Islamic insurance and reinsurance is mutual protection and mutual responsibility

In 2015, NBK introduced amendments to takaful and takaful firms. Under the new Law, basic Islamic laws continue to apply such as the ban on interest, sharing profit and risk, avoiding gambling, tobacco and alcohol products. The updated laws also clearly state the main principles of Islamic insurance, which are mutual protection and mutual responsibility of the insured, within a system that all policyholders pay a contribution, usually on a yearly basis, to a pool of funds and receive compensation from the pool in case of loss. The pool would be managed by the takaful firm.

The 2015 amendments require takaful firms to get a license from the NBK to start operations.

Under the new laws, conventional insurance firms still cannot conduct Islamic activities through Islamic windows. Under the NBK's regulatory framework, all takaful firms must comply with the NBK's policies.

The new law still stipulates the use of the words "Islamic insurance" to avoid confusion with conventional insurance and not to mislead customers. This is a law that is not followed in many countries but could be needed for a country that is eagerly trying to establish its Islamic finance industry and distinguish Islamic firms from conventional ones.



<  
Astana capital  
city of Kazakhstan  
fireworks at  
Presidential palace.

## Takaful firms should segregate assets owned by policyholders from its own assets

Another area of development is the Islamic Insurance fund, which is a fund that is created by the contribution received from policyholders in addition to amounts received through investing the contributions. The common pool of funds and assets belong to the policyholders but is managed by the takaful firms on behalf of the policyholders. As a result, a takaful firm should segregate the assets owned by policyholders from its own assets. Also, in the event of bankruptcy, a takaful firm cannot use the assets owned by policyholders to pay off creditors.

The investments must be Shariah-compliant and permitted by the Islamic Insurance Council. (See following section about the role of the Islamic Insurance Council.) With regards to the management services provided by the firm, the firm may receive a fee based on the contributions as well as a fee linked to profits received from investments, or both.

The laws clearly protect policyholders in case the funds are insufficient to reimburse the policyholders. In case of shortfall, a takaful firm must make up the shortfall through an interest-free loan which has to be repaid through future surpluses of the funds.



THE 2015 AMENDMENTS REQUIRE TAKAFUL FIRMS TO GET A LICENSE FROM THE NBK TO START OPERATIONS. UNDER THE NEW LAWS, CONVENTIONAL INSURANCE FIRMS STILL CANNOT CONDUCT ISLAMIC ACTIVITIES THROUGH ISLAMIC WINDOWS.



### **The Islamic Insurance Council is an independent body appointed by the firm's board of directors**

In the 2015 amendments to the Islamic insurance law, takaful firms must have an additional body to oversee their operations and to ensure they comply with principles of Islamic insurance. The Islamic Insurance Council is an independent body appointed by the firm's board of directors. Apart from day-to-day operations, the Islamic Insurance Council is also responsible to ensure that the funds are invested in Shariah-compliant products.

The new amendments outline the following principles that Islamic insurance firms should adhere to:

- Policyholders are entitled to mutual protection;
- Islamic insurance firms are prohibited from receiving income from investing assets (or provision of loans) in the form of interest;
- Islamic insurance firms are prohibited from insuring (reinsuring) or financing activities related to production or trade in tobacco, alcohol, weapons, ammunition, gambling and other businesses prohibited for insuring (reinsuring) or financing by the Islamic Insurance Council.

### **Islamic leasing companies can operate without a license from the NBK**

One of the structures introduced under the new Islamic finance law was the introduction of Islamic leasing, also known as, *ijarah*. Under the *ijarah* structure, some of the risks remain with the lessor, such as assuming the responsibility of the maintenance and insurance of the leased assets. On the lessee side, any loss, theft or destruction of the leased assets does not fall under the responsibility of the lessee, and the lessee is then not obliged to continue payments. In addition, the law states that the lessee is prohibited to employ the leased assets in activities which go against Islamic finance principles. The law also requires the lessor, if not an Islamic bank, to maintain a separate accounting of income and expenses under Islamic leasing from revenues and costs of other activities.

Both Islamic and conventional leasing companies can operate without obtaining a license. Instead, Islamic leasing can be performed by either Islamic banks under the Islamic banking license or general corporations i.e. joint stock companies. Similar to Islamic insurance, Islamic leasing also requires the companies to have an Islamic Leasing Council to oversee and ensure Shariah rules and procedures are followed. The following are the principles that Islamic leasing companies should comply with:

- Prohibition on financing by lessor of activities relating to production of and/or trade in tobacco, alcohol, weapons and ammunition, gambling, as well as other types of entrepreneurial activity, financing of which is prohibited by the Council on Islamic Financing Principles;
- Prohibition on obtaining by lessor of remuneration as a percentage of the investment, pertaining to Islamic leasing.



# ABZALOV KANAT MARATULY

Head of Project Management Department of “DBK-Leasing” JSC subsidiary of “Development Bank of Kazakhstan”



**ABZALOV KANAT MARATULY** is the Head of Project Management Department of “DBK-Leasing” JSC subsidiary of “Development Bank of Kazakhstan”. He has more than 10 years of experience in banking sector of Kazakhstan, holding different positions like risk manager and credit manager in the commercial banks, branch manager of foreign bank and deputy general manager of leasing company.

Mr. Kanat holds a MSc in Financial Management from Edinburgh University and both Bachelors and an MBA from KIMEP in Almaty, Kazakhstan.

### 1. How do you see Islamic finance service industry in Kazakhstan in the new 5 years from now?

Islamic finance is the system based on high ideals and moral values of Islam and, at the same time, used within the frameworks of modern system. Implementation of the Islamic financing in Kazakhstan may open new possibilities for the development of the real sector of the Kazakh economy.

We see huge development and governmental support of Islamic finance services industry in Kazakhstan. Next year government plans to issue 3 billion Sukuk, and these funds must be allocated properly.

Nowadays, we see the growth of Al-Hilal bank products and market share. People started using Islamic products actively. In 5 years we hope to see new market players in Kazakhstan and more popularity among people.

Around half of Kazakhstan’s 17 million population are Muslims, so we can fore see proper growth Islamic finance industry in future in Kazakhstan.

### 2. Development Bank of Kazakhstan had issued Kazakhstan’s debut sukuk Mudharabah and DBK Leasing is among the beneficiaries of the sukuk proceed. From your point of view, what are the pushing factors which led to this issuance?

The main pushing factor is strong governmental support to introduce new product. The introduction and usage of new products opens opportunities for companies and other interested parties. Kazakhstan government understands the perspectives of new funding opportunities for Kazakh entities.

### 3. What would be the impact of this issuance to the sovereign sukuk the government of Kazakhstan which is now under study and will be issued soon?

As Kazakhstan is growing country, the financing issue is always under concern. We are aware of the planned issuance of Sukuk for the sums around 3 billion USD, which will add flexibility to our government to fund strategic projects and continue the plan of industrialization of the country. As the usage of the funds must be in compliance with Shariah rules, so more and more parties will be involved, intermediaries and final users.

**4. Leasing companies like DBK Leasing do not govern under Islamic finance legislation. Do you such companies should be governed under the legislation, or just status quo? Why?**

Today leasing companies are governed under Finance Leasing Law. To become fully Islamic finance organization would be very hard, as we operate as operators of different governmental programs to support local business which are established in accordance with conventional banking conditions.

It is possible to create a special Islamic finance subsidiary and govern it under Islamic finance legislation. Surely the issue needs to be approved and developed under the approval of parent companies.

**5. What are the advantages and disadvantages for not having to be governed under Islamic finance legislation?**

For sure the main advantage is integrity and honesty; in Islamic

finance all the actions and activities (charges and etc.) are clear and known in advance.

During the financial crisis, the Islamic banks were less affected, because all the securities were backed by real assets.

Islamic finance emphasizes on risk sharing, the bank shares the risk with the client which very convenient and decreases involvement in fraud transactions.

The disadvantages are legal issues and concerns, countries need to adjust their legislation to Shariah rules, which takes time and enormous efforts to apply.

Also there are discrepancies between local and Islamic accounting methods, and inconsistencies between some Islamic banking principles and Kazakh tax legislation.

**6. To further growing the SME industries, what are areas that need further attention from the government?**

There are many questions that need attention from government to support development of SMEs including legal, taxation, financing, certification and etc.

We are as a financial institution can advise pay attention to make funding more affordable to SMEs to finance their initiatives to support production of goods and services in Kazakhstan.

**7. Unlike banks where they can offer deposit based products, being a leasing company, does DBK have sustainable funding concern? If yes, how do you manage this?**

DBK Leasing is the subsidiary of Kazakhstan Development Bank, currently the funding occurs through several sources:

1. Credits from parent company
2. Coupon bonds issuance on KASE
3. Governmental budget funds and National Fund sums released to support national programs

We have some long term funding problems in local currency, which is the most demanded currency to support financing initiatives.

Sukuk issuance could also be one of the options to fund our current operations, but we have to have pipeline of the projects meeting the Shariah requirements.

**8. Do you think Kazakhstan should have its own SME bank, dedicated to support the funding issues?**

As far as I know there are departments in most of the banks that deal with financing the SMEs. To create solely SME bank is possibly very interesting idea. Targeting just SMEs and meet their needs in depths could lead to further development of SMEs in Kazakhstan.

## A new structure enabling customers to benefit from cash financing

Commodity murabahah (tawarruq) has been added to the existing banking structures under the new law. The new structure is an addition to the other Islamic modes musharakah, murabahah, ijarah, wakalah, mudarabah and qard al-hasan. Tawarruq remains one of the few structures in Islamic finance that provides cash financing to customers. The tawarruq structure involves buying commodities from a third party with immediate delivery and spot payment. The law also says that in order for the commodities to be used, they have to be traded on certain permitted international exchanges or over the counter (OTC).

The following are the requirements of a commodity exchange in order to be qualified as a permitted exchange:

- Commodity exchange operates in the territory of the State having the sovereign rating not lower than A from one of the rating agencies,
  - Information on the volume and number of stock transactions made on the commodity exchange shall be published in the statistical reports, and placed on the website of the World Exchange Federation.
  - The list of international commodity exchanges, where goods may be bought and sold within the framework of financing of individuals and legal entities in capacity of trade agent, through provision of commercial credit under the condition of subsequent sale of the goods to a third party shall be established by the Government of the Republic of Kazakhstan.
- the list whereof shall be established by the relevant authorised body;

## Public Awareness

### Awareness remains a challenge to be tackled through increasing Islamic finance activities and education programmes

**D**espite the huge Muslim population in Kazakhstan, most people lack awareness about the fundamentals of Islamic finance. According to our survey conducted in Kazakhstan to gauge the level of understanding of the differences between Islamic and conventional financial services products, 40% of participants said that they have no knowledge of their differences but that they need to find out more, another 39% said that they have no knowledge of their differences and that they don't need to find out more.

Overall, there is not a high level of awareness about Islamic finance-related matters in Kazakhstan. Since the country's independence in 1991 from the USSR, there have been no universities or institutions that offer Islamic degrees, but majority of Kazakhstan universities have elective courses on IF.

There hasn't been much research activity, either. Since 2012, only three research papers were published addressing different areas of Islamic finance: the first about the development of Islamic finance in Kazakhstan in 2013, the second on the opportunities related to securitization and sukuk in 2013, and the third addressing problems in the development of the Islamic insurance market in 2012. No Islamic finance-related research papers were published in 2014 but with the new laws allowing more Islamic finance activities, we could see more research papers pertaining to the new law and tackling some of the challenges that are holding back the development of Islamic finance.

The 12th Islamic Financial Services Board Summit (IFSB) was held in Kazakhstan in May 2015. Among other issues addressed by the key market players, the main discussion surrounded the new regulatory developments and their impact on the Islamic financial services industry.



# CHALLENGES AND PERSPECTIVES OF ISLAMIC FINANCE EDUCATION IN KAZAKHSTAN

**Alfiya R. Salikhova**, Head of Research Committee, The Association for Development of Islamic Finance (ADIF)  
**Timur Rustemov**, Head of Educational Committee, The Association for Development of Islamic Finance (ADIF)



**MS. ALFIYA SALIKHOVA, PHD**

is a team-leader of the research project called “Islamic Finance: Theory, Practice and Regulation Issues” supported by the Government of the Republic of Kazakhstan. In 2014, Alfiya became a winner of the contest organized by the Ministry of Education and Science of the Republic of Kazakhstan and was conferred the title of “The Best Professor”.



**TIMUR RUSTEMOV**

is a Deputy Chairman, Director of Education Committee, Member of the Presidium of ADIF. He is a Chartered Islamic Finance Professional from INCEIF. He is currently pursuing Master’s Degree in Islamic Finance from the same university. He holds a bachelor degree in Economics from Kazakh National University named after Al-Farabi, Almaty, Kazakhstan. He has served as a lecturer in Islamic Finance faculty at University Kuala Lumpur and been involved in Islamic microfinance projects by INCEIF.

Islamic finance education in Kazakhstan right now is at the initial stage of its development. Due to the adoption of specific legislation in 2009 - 2011 and founding of the first financial institutions offering Islamic financial products the necessity to introduce new academic disciplines on Islamic Finance into master’s and bachelor’s degree courses for economic specialties is of great importance. The necessity became vivid in 2012 after the Government of Kazakhstan approved the “Road map on the development of Islamic Finance until 2020” program where a specific attention to academic issues was given.

For today, seven leading Kazakhstan Universities offer some elective courses on Islamic Banking, Takaful and Islamic Law to their students. These are Al-Farabi Kazakh National University, L. Gumilyov Eurasian National University, Turan University, New Economic University, Master’s Degree Courses of National Bank of the Republic of Kazakhstan, S. Toraihyrov Pavlodar State University, etc.

A vivid interest of pedagogic society towards the development of academic programs on Islamic Finance is a certain achievement of the past period. In spite of the fact that the industry is tiny and the demand for Islamic finance graduates is low leading Kazakhstani universities constantly develop new courses to train students who can become a driving force of the industry in the future.

It is necessary to note that starting from 2014 the National Bank of Kazakhstan indicated the development of human capital resources as an important condition for the development of Islamic finance in the country. In March 2015, the National Bank of Kazakhstan signed memorandum on long-term collaboration with Association for the Development of Islamic Finance and in the framework of this collaboration organizing and holding of different conferences, forums, seminars and trainings with the popularization of Islamic finance in the country is stipulated.

The table below reflects the tasks on the development of Islamic Finance education indicated in the Road Map and the results of their implementation.

Tasks	Activities
<p><b>1.</b> <b>To add 'Basics of Islamic Finance' course into the list of elective disciplines for students of economic specialties</b></p>	<p>In 2014, the National Bank of Kazakhstan (NBK) sent the official letter to all universities in Kazakhstan to include the course 'Basics of Islamic Finance' into the list of elective disciplines for students of economic specialties</p> <p>In January 2015, the research group under the guidance of the Chairman for Association for Development of Islamic Finance (ADIF) Yerlan A. Baidautet worked out the first Textbook in CIS countries "Basics of Ethical (Islamic) Finance" both in Russian and Kazakh. The Textbook under the support of Ministry of Education and Science of the Republic of Kazakhstan and IRTI was distributed among 70 Kazakhstan's universities.</p> <p>Today the research group is working over the new textbook "Islamic Finance: Theory, Practice, Regulating Issues". The presupposed date of release is December 2015.</p>
<p><b>2.</b> <b>To study experience and methodology of Islamic finance industry</b></p>	<p>In 2013 the Ministry of Education and Science of the Republic of Kazakhstan allocated grant to study theoretical and practical issue of Islamic finance. Within this grant the experience of Islamic finance industry in Bahrain, Malaysia, UAE, Turkey, UK, USA is been studied. It is expected that the results will be presented to the public in January 2016.</p>
<p><b>3.</b> <b>To conduct round table discussion on Islamic finance issues with attraction of scientists and practitioners</b></p>	<p>In September 2014, in the framework of the 4th Kazakhstan Islamic finance conference the Islamic Finance Training and Education Aspects Session was held. During the session the issues on Islamic finance education with participation of professionals and professors from Saudi Arabia, Malaysia, UK, Turkey, and Kazakhstan universities were discussed.</p> <p>In May 2015, 12th Summit IFSB was held in Almaty with motto "Core Principles for Islamic Finance: Integrating with the Global Regulatory Framework". The Summit was attended by more than 150 delegates from 25 countries comprising of senior officials from supervisory and regulatory bodies as well as representatives from international institutions, market players, accreditation, law firms, IT providers, insurance and Takāful, academia as well as other stakeholders of the Islamic financial services industry. The main agenda of the event was new regulatory developments and the impact on the Islamic Financial Services Industry.</p>
<p><b>4.</b> <b>To conduct on the regular basis the workshops for representatives of state authorities</b></p>	<p>In February 2015, the representatives of NBK, quasi-governmental and financial companies participated in the program "Certified Islamic Banker" held by CIBAFI.</p> <p>In August 2015, the first Summer School on Islamic Finance for representatives of Kazakhstani higher education institutions and specialists of the NBK was organized by ADIF in Almaty.</p> <p>Starting from July 2015, ADIF and NBK is going to launch medium-term educational program on introducing the number of training workshops on Islamic finance and <i>Sharia'h</i> Law for representatives of financial sector and universities.</p>
<p><b>5.</b> <b>To establish Training and Analytical Centre for studying Islamic finance at university level</b></p>	<p>In March 2014, the academic centre on Islamic finance was established on the base of Turan university.</p>
<p><b>6.</b> <b>To consider the possibility for Kazakhstani specialists to study Islamic finance in foreign universities</b></p>	<p>In 2013, such fields of study as Islamic Finance, Islamic Finance and Management were included into the list of specialties for granting International Scholarship 'Bolashak' ('The Future') of the President of Kazakhstan to obtain master degrees in programs offered by Durham University, Nottingham University, Birmingham University, New Orleans University, etc.</p>



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### Challenges

Despite some initiatives towards the development of Islamic Economics & Finance education in Kazakhstan there are some challenges:

1. Lack of literature on Islamic finance in Russian and Kazakh;
2. Lack of qualified teachers of Islamic Economics & Finance & Jurisprudence;
3. Absence of Bachelor, Master and PhD programs on Islamic finance offered by Kazakhstani universities;
4. Low level of scientific discussions among local researchers, professors in terms of publications, participation in International conferences on Islamic Economics & Finance;
5. Lack of access to International scientific journals, data base on Islamic Economics & Finance & Jurisprudence.

### Perspectives

In spite of indicated difficulties the process of their overcoming is a matter of time. The increased interest in development of Islamic Finance of the largest participants of the process: the Ministry of Education and Science, Association of Higher Education Institutions of Kazakhstan, the National Bank of Kazakhstan and other representatives of financial centers of the Republic stand for that.

Association for Islamic Finance Development together with the leading education institutions INCEIF (Malaysia), BIBF (Bahrain), CIBAFI (Bahrain) are planning to start up some joint academic programs. Starting of Masters in Islamic

Finance Practice (MIFP, INCEIF) Program on the basis of one of the leading Kazakhstan universities is also planned in the nearest future.

It is clear that establishing Astana International Financial Center will give a boost to the development of Islamic Finance education. Appearance of new players, introduction of new products will support the increase of the demand for highly-qualified specialists in the sphere of Islamic Law, Taxation, Accounting and structuring of transactions. The development of academic programs together with the leading institutions of Bahrain and Malaysia applying international educational standards, best practices, and Kazakhstan law will help to prepare competitive specialists for the industry.

## International relations

### Islamic Development Bank (IDB) extends its partnership with Kazakhstan until 2017



To identify the model of Islamic finance industry formation it is important to discuss the source of capital of industry financing. According to IDB estimates, the amount of financed projects in Kazakhstan between 1997 and 2013 totalled US\$ 1.3 bln. Through the IDB Group, Islamic finance has been involved in solving many economic and social challenges through: (i) investing in infrastructure (transportation, water sanitation) and health care; (ii) increasing access to finance for business; and (iii) receiving expertise through working with international financial institutions.

It is worth noting the experience of the IDB in collaboration with a Kazakhstan quasi-governmental financial institution – the Fund for Financial Support of Agriculture (FFSA). In 2011, FFSA concluded a loan agreement with IDB for the amount of US\$ 9.7 mln. The main goal of this agreement was to contribute to economic growth by providing employment in rural areas. In 2013-2014, FFSA, using murabahah contracts, financed 507 projects that amounted to US\$ 8.7 mln. The rural residents of all Kazakhstan regions participated in this program. Everyone who met the requirements of the program were able to get access to financing regardless of religious belief. It is necessary to underline that the use of products based on murabahah contracts by FFSA not only improved the economic circumstances of recipients but also boosted the penetration of Islamic financial services into the Kazakh market. The FFSA Board of Directors has approved the murabahah as one of its regular daily lending products that allows a certain amount of state budget resources to be allocated according to Shariah principles.

As part of its mission, IDB continues to be part of the development of Islamic finance in Kazakhstan following the signing of a US\$2 bln framework agreement aimed at improving cooperation for 2015-2017. The partnership is to support the country in establishing the Islamic Organization for Food Security in the framework of the Organisation for Islamic Cooperation (OIC) to be based in Astana. Historically, the IDB supported Kazakhstan in 22 projects as well as giving \$ 1.2 billion worth of financing in sectors such as agriculture, education, and different infrastructure projects including constructing roads and water supply.

IDB has also been active in establishing an Islamic leasing company, Kazakhstan Ijara Company (KIC), through its subsidiary the ICD (Islamic Corporation for the Development of private Sector) along with other shareholders from Kazakhstan. ICD holds 36% of the company followed by 18% owned by Zaman Leasing.

### Bahrain plans several partnerships with Kazakhstan including establishment of an Islamic bank

Kazakhstan also enjoys a very strong relationship with Islamic finance stronghold Bahrain and in April 2014 bilateral relations intensified following the visit of the Bahraini king, His Majesty King Hamad bin Isa Al Khalifa, to Kazakhstan. During the king's visit, 12 agreements were signed in several fields, including information, investments, agriculture and industrial. Other areas include exchanging expertise between the two countries as well as establishing an Islamic bank in Kazakhstan. The King stated that Bahrain would join the Astana-based Islamic Food Security Organization, an organization supported by the Kazakhstan government and IDB.



<  
View of the largest mosque in Astana, a bird's-eye at night.

# 3 Banking Sector at a Glance



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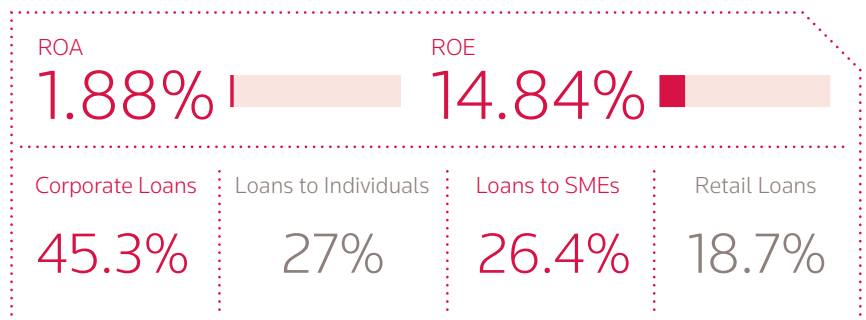
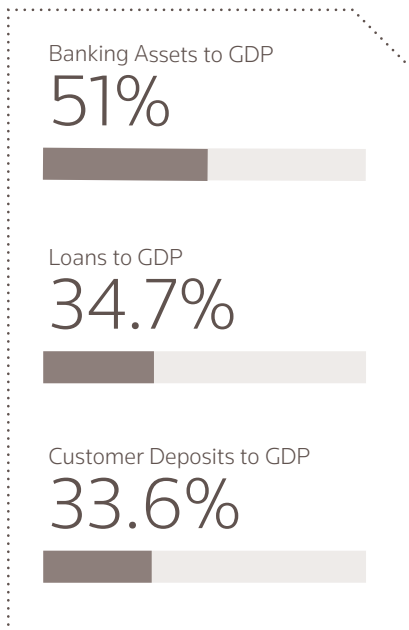
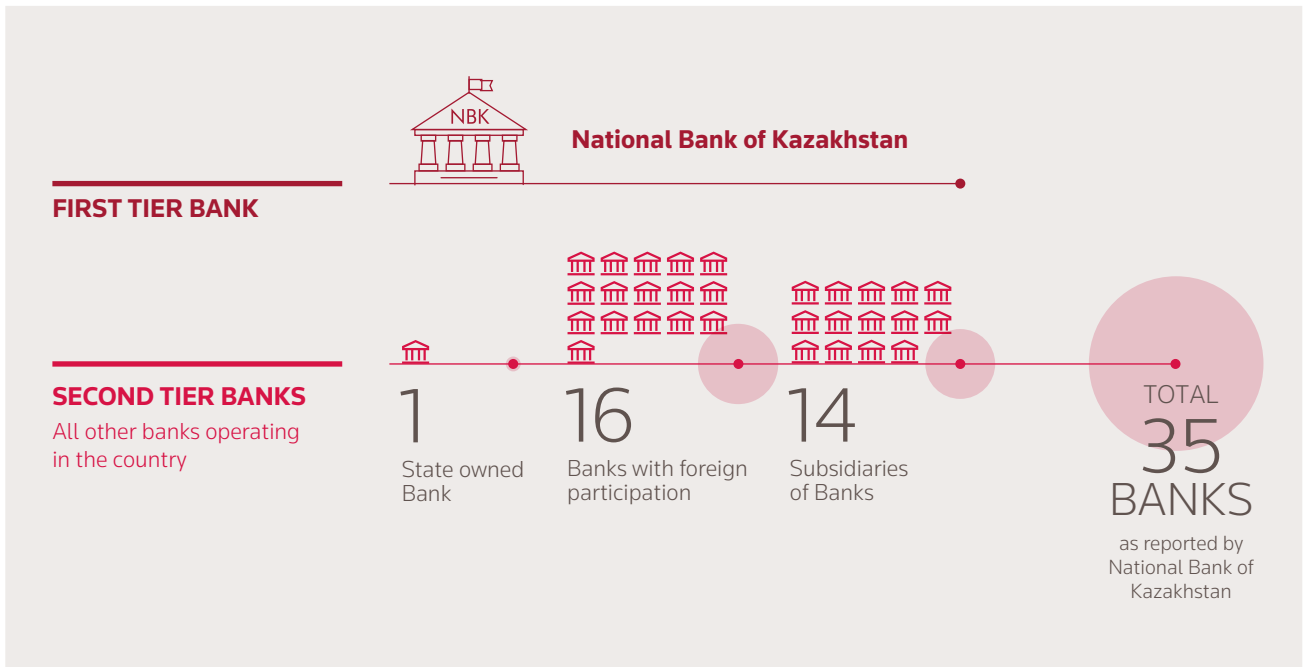
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# Banking System Landscape





\*Data as of October 2015

- FINANCIAL SECTOR DEVELOPMENT TO 2030 – OBJECTIVES**
- 1 | Maintain soundness of the financial system in order to reduce any costs to society and government in the case of shocks to the system;
  - 2 | Increase effectiveness of the financial sector in an environment of economic integration and globalisation;
  - 3 | Improve infrastructure and create optimal conditions for efficient development of the financial system;
  - 4 | Expand resources for the financial sector’s growth, including through financial products that meet the needs of the economy;
  - 5 | Maintain balanced economic conditions and reduce credit risks in the economy.

### Banking sector holds the lion’s share of Kazakhstan’s financial system; however, the banking sector is still under pressure

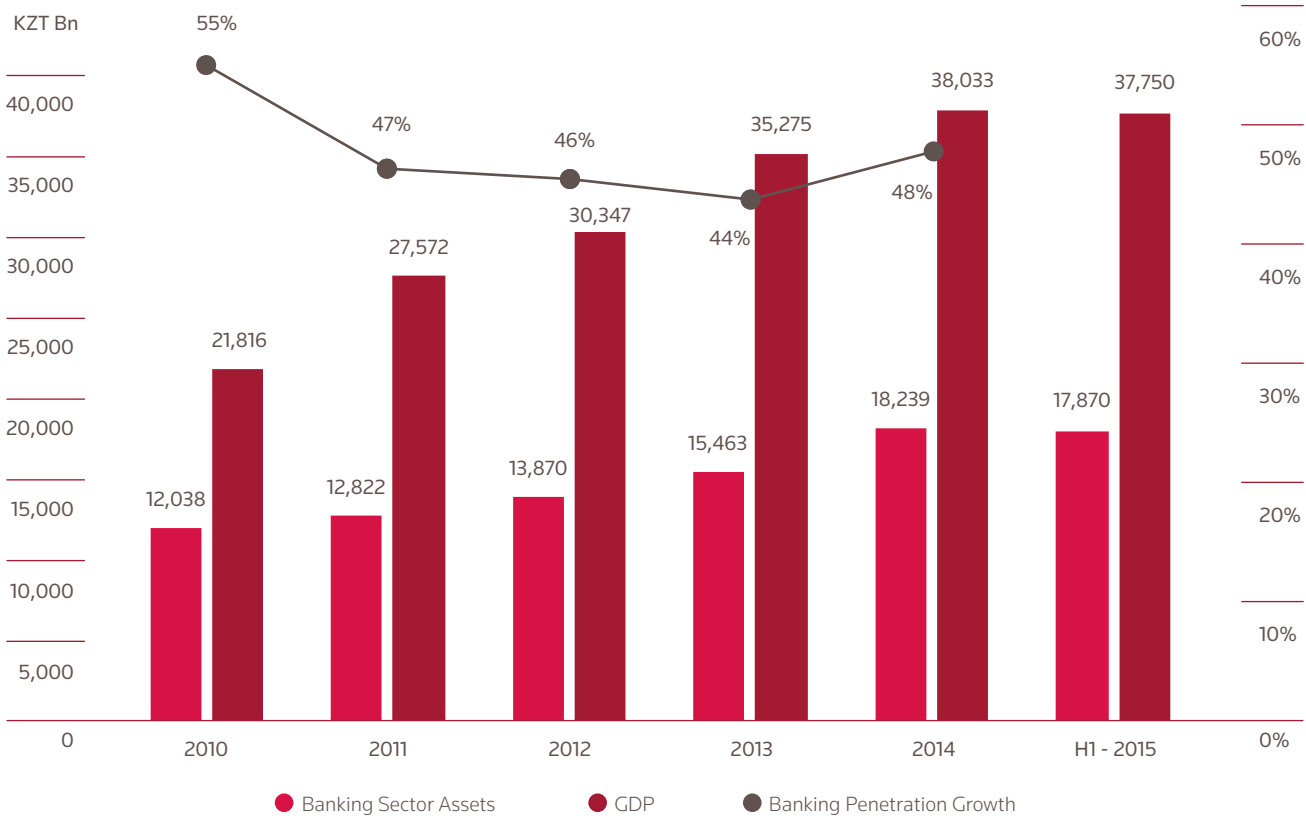
The financial system in Kazakhstan is dominated by banks. The banking sector is crowded, consisting of 35 commercial banks, which hold 77% of total financial system assets (IMF, August 2014) and 42.8% of GDP (National Bank of Kazakhstan, March 2015). The country has a two tier-banking system: the central bank, the National Bank of Kazakhstan, represents the first tier and commercial banks make up the second tier.

Kazakhstan’s banking sector suffered significant losses during the global financial crisis of 2008, suffering from poor asset quality, lack of liquidity and equity, wide gap between assets and liabilities and distress profitability which ultimately led to an unstable banking sector. As a result, the

republic put in place prudential regulations to strengthen control over the banking sector. One of the main prudential requirements announced in 2014 was the transition to Basel III, which will ultimately push smaller banks to consolidate.

Kazakhstan wants to re-position its banking sector to have a greater influence on its overall economic development. One of the targets expected to be achieved in 2020, in the “Concept for the Financial Sector Development of the Republic of Kazakhstan till 2030”, is for an increase of banking assets contributions to the country’s GDP to at least 80% of non-oil GDP and loan portfolio to account for at least 60% of non-oil GDP.

#### BANKING ASSETS PENETRATION AS % OF GDP



Source: Banking Assets – Performance of Financial sector statistics, National Bank of Kazakhstan. GDP – World Economic Outlook Database April 2015, IMF, whereas 2014 and 2015 estimate figures.



In the Islamic banking sector, Kazakhstan was the first former Soviet state to issue Islamic finance guidelines in 2009. The country's Islamic finance industry is still in its nascent stage with total assets of KZT 14,148 million (US\$ 75 million) at the end of 2014, compared to total banking assets of KZT 18,239 billion (US\$ 97 billion) in the same year. The republic has only one full-fledged Islamic bank, Abu-Dhabi-based Al Hilal Islamic Bank, which started operations in 2010. Al Hilal focuses on governments and large corporate companies but aims to also equally focus on the retail market with plans to offer a full range of retail Islamic products. Islamic banks in Kazakhstan are categorised on a par with other commercial banks, known as Tier 2 banks.

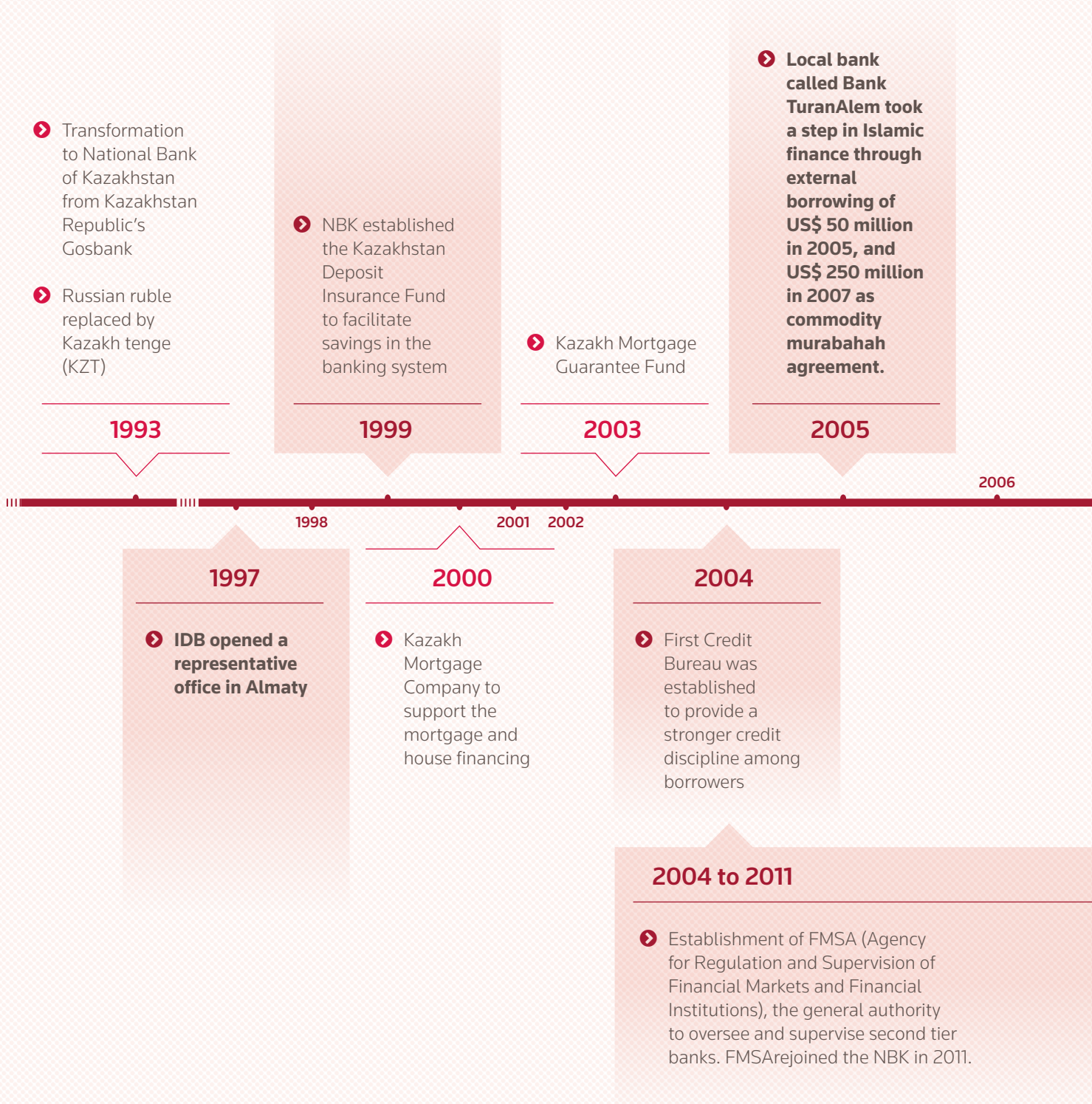
Kazakhstan has a "Road map on the development of Islamic Finance until 2020" that outlines

the development and implementation of Islamic finance in the republic which will create condition for their activities. The country is a member of the Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and International Islamic Financial Markets (IIFM).



ONE OF THE TARGETS EXPECTED TO BE ACHIEVED  
IN 2020, IN THE "CONCEPT FOR THE FINANCIAL  
SECTOR DEVELOPMENT OF THE REPUBLIC OF  
KAZAKHSTAN TILL 2030", IS FOR AN INCREASE  
OF BANKING ASSETS CONTRIBUTIONS TO  
THE COUNTRY'S GDP TO AT LEAST 80%  
OF NON-OIL GDP AND LOAN PORTFOLIO TO  
ACCOUNT FOR AT LEAST 60% OF NON-OIL GDP.

# Banking Sector Evolution in Kazakhstan



- Several mergers and acquisitions took place. BTA, Alliance, HalyBank, KKB, and Temirbank were bailed out by the government.
- KKB and HalyBank bought back their shares after the credit crunch. BTA and Alliance held under government management.

## 2007 to 2012

- Alliance Bank received US\$ 150 million Shariah-compliant syndicated loan facility from Middle East banks.

2007

- Establishing the first Islamic Bank in Kazakhstan, Al Hilal Islamic Bank, a subsidiary of Al Hilal Bank, UAE.

2010

- The first country in the former Soviet Union that issued a USD 75 million Sukuk by the Development Bank of Kazakhstan

2012

2011

2008

2009

- Islamic Finance Law (2009)

2013

2014

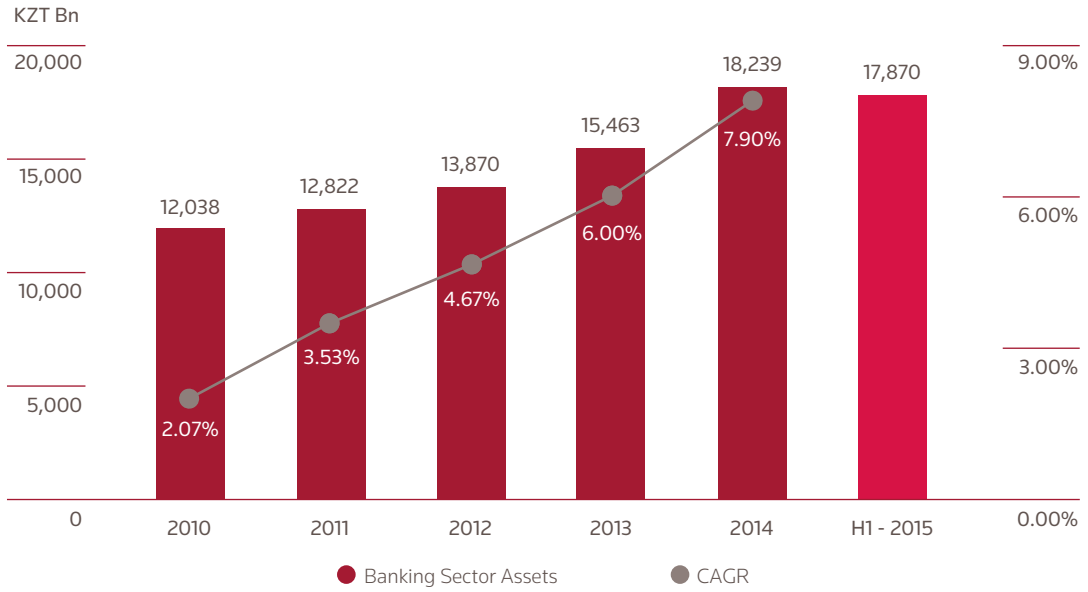
2015

- Amendment to the law to allow more Islamic finance activities and structures, with specific restrictions to conversion of conventional banks into Islamic banks

## Sector Landscape<sup>5</sup>

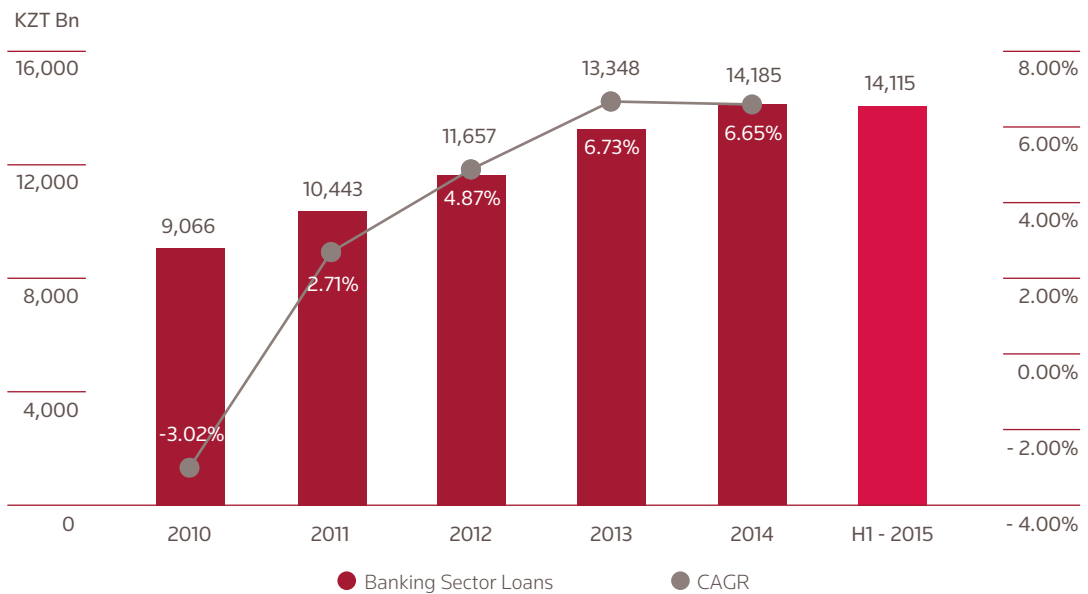
Note: All year end data are based on January 1st of the next year

### KAZAKHSTAN BANKING SECTOR ASSETS



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.

### KAZAKHSTAN BANKING SECTOR LOANS



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.

### Steady growth in banking sector assets accompanied by growth in loans

Total assets of Kazakhstan’s banking sector reached KZT 18,239 billion in 2014, up 18% from KZT 15,463 billion in 2013. In June 2015, total assets stood at KZT 17,870 billion, which indicates a faster growth pace of banking assets during 2015 compared to previous years.

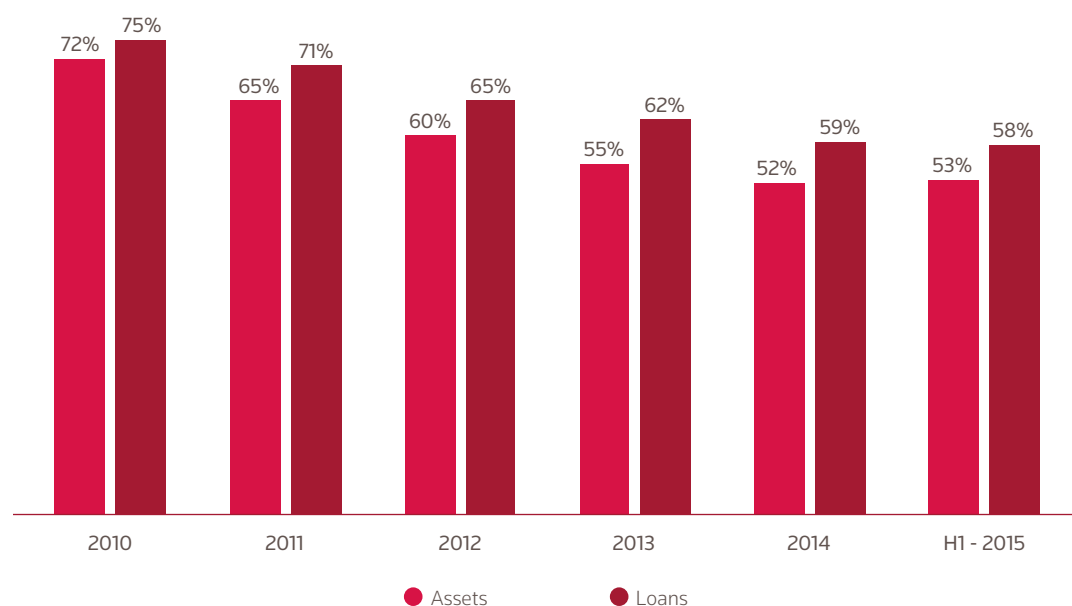
Assets growth in Kazakhstan’s banks is highly correlated to the growth in loans. The volume of loans accelerated during 2014 and reached KZT 14,185 billion compared to KZT 13,348 billion in 2013. This represents an increase of 6% between 2013 and 2014. Loans to non-banking legal entities make up the majority share of Kazakhstan’s banking sector loans. But banks in the republic tend to favour lending to individuals, given the high interest rates charged on consumers compared to businesses. As of June 2015, loans extended to non-banking legal entities reached KZT 8,094 billion, while individual loans reached KZT 3,974 billion.<sup>6</sup>

### High concentration levels of assets and loans; however, declining trend is seen

The banking sector in Kazakhstan is dominated by a handful of banks; in 2014 5 commercial banks held more than 50% of the total assets of the banking sector and almost 60% of the sector’s total loans. This dominance has eased considerably since 2010 when 5 commercial banks held 72% of total assets and 75% of loans.

High levels of concentration in only a handful of banks reflect a less competitive market and the ability of the big 5 to adversely affect pricing. In terms of assets concentration, the dominance of a few commercial banks may adversely affect new entrants into the market. From the loans perspective, high concentration levels would result in discriminatory reallocation of funds from small to large borrowers in which small borrowers would be more affected by the controlled lending rates than larger borrowers.

## CONCENTRATION AND COMPETITIVENESS OF BANKING SECTOR OF 5 COMMERCIAL BANKS (END OF 2014)



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.

### Addressing the high NPL rates is a key issue for the sector

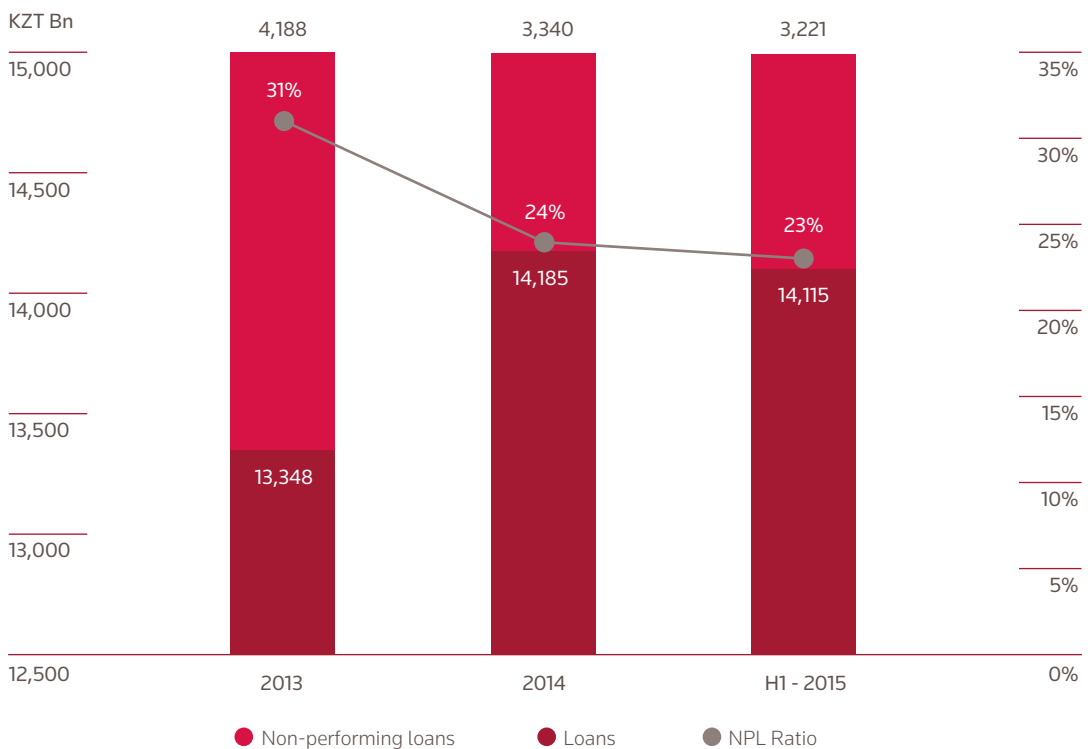
The banking sector in Kazakhstan has been suffering from a high level of non-performing loans that emerged during the financial crisis and which have still not been resolved primarily because of economic instability and currency devaluation in the years following 2008. However, the loan portfolios have been performing better since 2013. NPLs decreased to KZT 3,340 billion in 2014 compared to KZT 4,188 billion in 2013, and their share of loan portfolios also decreased to 24% in 2014 compared to 31% in 2013.

Such high NPL ratios affect banks' profitability, exposes them to deterioration in their credit quality and limits their ability to increase capital. National Bank of Kazakhstan took a number of steps to manage second-tier banks' NPLs, such as changes in tax laws and normative legal acts. In addition, a mandatory maximum level of 10%

will be set for non-performing loans as a prudential ratio from January 1, 2016, and a violation or non-compliance will lead to a withdrawal of the institution's banking license or a dismissal of top management.

The republic's NPLs are mainly those to corporations and SMEs. At the same time Kazakhstan's banking sector is witnessing a growth in retail lending. To check the quality and expansion of consumer loans, a cap of 30% annual growth on consumer loans was introduced by the central bank and commercial banks have been ordered not to allow individuals to spend more than half of their monthly income on loan repayments. The government's intention is to reduce the bad loan rate and lower the growth in consumer lending.

#### NON-PERFORMING LOANS\*



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.  
 \* Loans with overdue payments over 90 days  
 \*Data available from 2013 onwards

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## COMPETITIVE FINANCIAL ASSESSMENT (THE FIVE TOP-PERFORMING BANKS, BASED ON TOTAL ASSETS IN DECEMBER 2014)

	Top-five banks' average	Bank Center Credit	BTA Bank Kazakhstan	Halyk Bank Kazakhstan	Kazkomm	SB Sberbank of Russia
<b>CAPITAL ADEQUACY</b>						
Equity to total assets	12.25%	7.89%	13.89%	15.55%	12.46%	11.47%
CAR ratio	16.72%	15.76%	18.93%	19.27%	16.24%	13.40%
<b>ASSET QUALITY</b>						
NPLs to loans	61.91%	10.47%	265.32%	10.83%	20.24%	2.66%
Provisions to loans	92.34%	19.72%	374.43%	20.95%	42.56%	4.05%
Provisions to NPLs	117.49%	132.09%	105.99%	118.22%	136.10%	95.04%
<b>EARNINGS AND EFFICIENCY</b>						
<b>Earnings – profitability ratios</b>						
Net income to assets (ROA)	2.05%	0.05%	5.36%	3.29%	-0.95%	2.50%
Net income to equity (ROE)	10.04%	0.63%	14.04%	21.04%	-7.16%	21.66%
<b>Efficiency ratios</b>						
Operating expenses to operating income	74.48%	93.66%	76.78%	121.12%	35.72%	45.13%
Operating expenses to total assets	3.04%	2.51%	6.59%	2.19%	1.40%	2.52%
<b>LIQUIDITY AND FUNDING</b>						
Interbank lending to total assets	4.97%	0.99%	2.06%	1.12%	8.14%	12.53%
Interbank borrowing to total assets	11.91%	11.34%	37.77%	2.91%	5.45%	2.08%
Loans to deposits	85.27%	88.35%	50.92%	80.11%	119.55%	87.44%

All financial data provided in the table were calculated by using the banks' financial statements for the year end 2014



## Introducing asset-based lending could be the solution to reducing negative loans and increasing market liquidity

Regulations and a prudential framework that address provisioning requirements have had a positive impact on the industry's performance. However, maintaining a flat level of development may not position the industry competitively in the short-to-medium term. In a healthy financial environment, which Kazakhstan hopes to reach mostly by focusing on writing off huge amounts of non-performing loans, the provision of loan losses should be enhanced to successfully maintain the declining trends of such loans, but at a faster base rate.

The changing economic climate globally and in the republic is likely to have an impact on both investors' and consumers' indebtedness. The bottom-line profit remains low over a three-year horizon. Although the banks are expecting a wave of high-yield consumer lending, which would shore up their operating-interest income, the provisioning policies to capture the credit risk still require stricter action by a higher authority.

In terms of liquidity and funding capacity, the banks have reasonable holdings of liquid assets against a buffer of deposit outflows, with large banks depending on corporate deposits. But, with their intention to increase consumer lending and decrease corporate loans, the banks are vulnerable in terms of funding and liquidity, due to the risk associated with the fragile confidence of retail depositors.

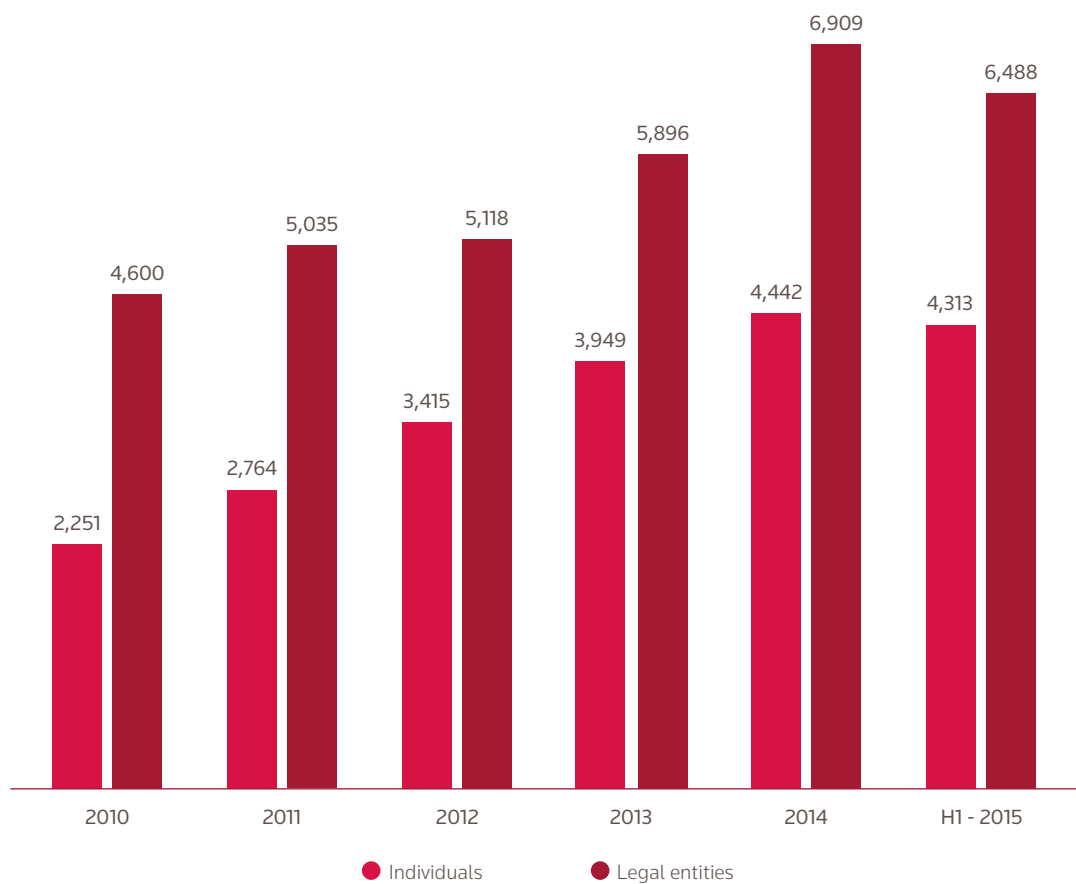
Therefore, mobilising the under-developed markets – such as the money market – as a means of short-term investment should be an area of focus for the top-five banks, at least at an early stage. Further, there is a need to embrace the use of risk-based supervision through risk-management systems and internal controls, in order to develop liquidity risk and to monitor the banks' capacity.

## Corporate and business deposits account for largest share of total banking sector deposits

By the end of 2014, banking deposits reached KZT 11,351 billion, divided between individuals' deposits holding 39% or KZT 4,442 billion and deposits by legal entities holding the lion's share of 61% or KZT 6,909 billion. Individuals' deposits and deposits by legal entities have been on an increasing trend since 2010.

Kazakhstan's local currency, the Tenge, plunged at the beginning of 2009 and 2014 and this encouraged many customers of Kazakh banks to transfer their deposits into dollars. This has persisted, largely due to mistrust in the local currency due to high volatility of the inflation rate. If this trend continues, Kazakh banks' lending abilities in Tenge will be severely affected.

### KAZAKHSTAN BANKING SECTOR DEPOSITS



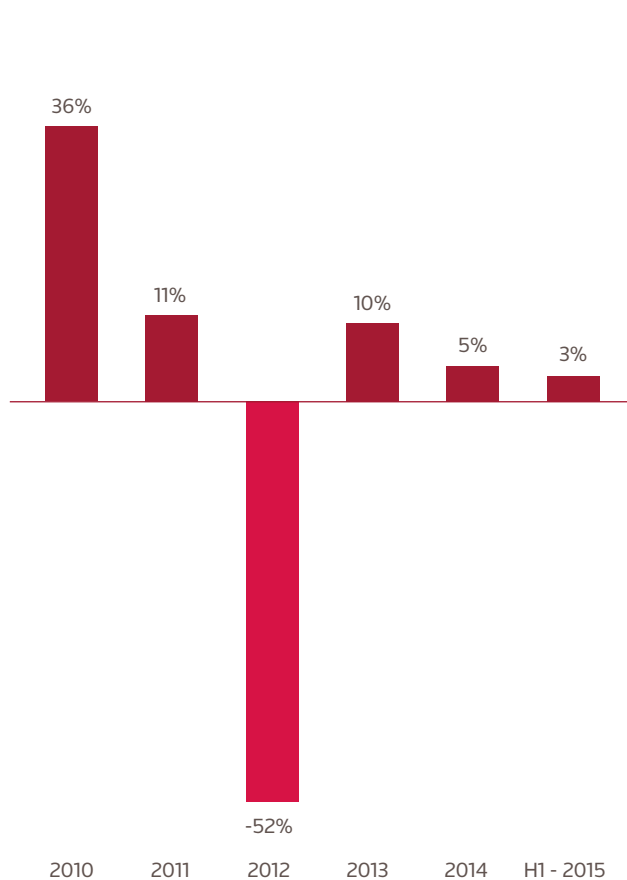
Source: Performance of Financial sector statistics, National Bank of Kazakhstan.

### Low profitability: the main challenge for Kazakhstan's banks

The banking sector's Return on Assets (ROA) stood at 5% by the end of 2014, reflecting half of the growth that was achieved in 2013. Kazakhstan's ROA is on a declining trend, which indicates both low earnings and high loan-loss charges. This can be related to the sharp de-

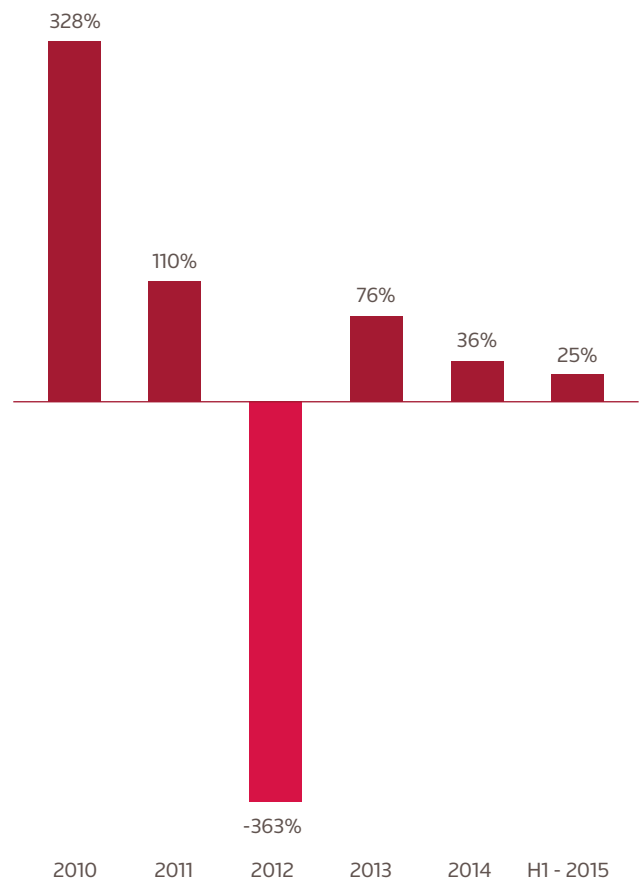
valuation in the Tenge in 2009 and 2014 that pushed the NPL level which has remained roughly constant at around the same level since then. Return on Equity (ROE) is also declining, plunging to 36% in 2014 compared to 76% in 2013.

RETURN ON ASSETS (ROA)



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.

RETURN ON EQUITY (ROE)



Source: Performance of Financial sector statistics, National Bank of Kazakhstan.



# DEVELOPING A SOUND ISLAMIC BANKING SYSTEM IN KAZAKHSTAN

**Nadir Burnashev**

Advisor, Financial Institutions' Association of Kazakhstan (FIAK)



**NADIR BURNASHEV**

is responsible for FIAK Islamic Finance activities. FIAK is the largest non-profit banking and financial association that unites 167 financial institutions.

Among the association's members are the first Islamic bank Al Hilal Kazakhstan and Association for Development of Islamic Finance (ADIF). The Association represents the interests of financial industry in central bank, government and parliament of Kazakhstan as well the administration of the President of Kazakhstan. It also coordinates and spearheads the activities on developing a sound and a vibrant financial sector in Kazakhstan.

Kazakhstan has made great strides to establish itself as one of the leaders in Islamic finance in the CIS region. Current legislation allows for the establishment of Islamic banks and other intermediaries and parliament is expected to approve, by the end of 2015, amendments to the legislation allowing the conversion of conventional to Islamic banks. There are other regulatory initiatives under way. This article will discuss what needs to be done to make Kazakhstan realize its potential in Islamic finance.

The financial system in Kazakhstan is open and well-developed<sup>1</sup>. As of September 1, 2015 there were 35 second-tier banks, out of which 16 are foreign, among them are 14 foreign subsidiaries. Total assets of the Kazakh banks reached 19,497 bn Kazakh tenge (US\$82 billion) as compared to 18,239 bn Kazakh tenge (US\$100 billion) as of January 1, 2015; this was an increase of 6.8 percent from the beginning of the year. The decrease in dollar terms is due to a recent tenge devaluation.

The Islamic financial system can play an important role in the economy of Kazakhstan. Currently Islamic banks hold less than 0.01 percent of total banking assets but they have the

potential to grow over the medium-term to US\$3-5 billion and reach 3-5 percent of total banking assets.

The average return on banking assets in Kazakhstan for top banks is 2.7 – 3.5 percent as compared to 1.2 – 1.8 percent average return on assets of Islamic banks in Malaysia and the GCC. The most lucrative business lines are the corporate sector and providing financing to well-defined projects and activities in a Shariah-compliant way. This could take the form of operational financing done on a recurring basis or longer-term investment financing done as project finance.

The profitability of financing Kazakh corporate, given the right structure and risk profile, may be twice higher than the profitability of financing similar corporates in Malaysia and the GCC. In terms of sukuk issuance Kazakhstan has a lot of unrealized potential as well. If one takes the last sovereign Eurobond issuance in October 2014 as an example, Kazakhstan has placed Eurobonds in two tranches for the amount of US\$2.5 billion : 10-year US\$1,5 billion Eurobonds and 30-year US\$1 billion Eurobonds yielding 4.07 percent (150bps to USD interest rate swap) and 5.11 percent (200bps), respectively. The initial book was

oversubscribed with order totaling over US\$11 billion. Similar interest was shown for the bonds of the Kazakh corporates rated on par with sovereign.

## **BANKING SYSTEM**

### **Credit Portfolio**

As of September 1, 2015, the credit portfolio makes up the lion's share of banking assets (63.6 percent of total assets) followed by other assets (17.4 percent of total), and cash and cash equivalents (14.6 percent of total). The credit portfolio comprises loans to legal entities (44.5 percent of total portfolio), loans to individuals (28.1 percent of total), out of which consumer loans represent 19.5 percent, mortgages made up 7.8 percent of the total, and loans to SMEs were 26.4 percent. Provisions equal 10.5 percent of total credit portfolio.

The growth of the credit portfolio slowed in the last few years due to unfavorable macroeconomic environment post global financial crisis. While the authorities and the banks were working to improve the quality of the credit portfolio post-2007 crisis, they were hit once again more recently by regional instability which slowed the economy.

### **Liabilities**

At the same time the liabilities side of the Kazakh banking system comprises client deposits (74.3 percent of total), securities (10.4 percent) and liabilities to non-residents (9.2 percent). In recent years the system has largely become an internally funded one with the share of external debt finance reduced significantly. This improves the stability of the banking system and its resilience to external shocks.

At the macro level the share of total banking system assets equals 47.2 percent of GDP, the share of the lending portfolio was 33 percent of GDP and the share of deposits was 30 percent of GDP.

The share of the five largest banks in the total banking system assets constitutes 58.8 percent. The size of Kazakhstan's banking system is smaller than that in Russia, Malaysia or GCC countries. The domestic banking system remains concentrated and plays a limited role in the overall economic development. Due to geographical factors (large territory and scattered population) it is better developed in the largest cities like Almaty, Astana where there is better infrastructure, higher economic activities and population incomes,

or Atyrau – an unofficial petroleum capital of Kazakhstan. On the other hand, most of the native Muslim population resides in rural areas and small towns where access to modern banking services remains challenging.

### **DEVELOPMENT OF ISLAMIC BANKING**

Corporate Islamic banking does not require substantial initial investment and may become profitable in a short time. On the contrary developing retail Islamic banking may prove a real challenge for Islamic banks, both domestic and foreign.

Kazakh authorities will insist, and rightly so, on developing Islamic retail products for the population and SMEs. This is one of the prime drivers to introduce and develop the Islamic financial system in Kazakhstan. On the other hand, potential foreign players and investors in Islamic finance have limited experience and exposure to the banking sector in this part of the world and may not be able to commit themselves readily to retail Islamic banking, at least in the early stages.

Local financial groups and investors keen to develop Islamic finance



THE ISLAMIC FINANCIAL SYSTEM CAN PLAY AN IMPORTANT ROLE IN THE ECONOMY OF KAZAKHSTAN. CURRENTLY ISLAMIC BANKS HOLD LESS THAN 0.01 PERCENT OF TOTAL BANKING ASSETS BUT THEY HAVE THE POTENTIAL TO GROW OVER THE MEDIUM-TERM TO US\$3-5 BILLION AND REACH 3-5 PERCENT OF TOTAL BANKING ASSETS.

do not have necessary human and intellectual resources, or market experience to develop and introduce Islamic corporate and retail banking products. One of the ways to solve this problem may be to establish joint ventures or strategic alliances between local financial investors and foreign counterparts. This may take the form of legal incorporation of local Islamic banks (newly established or converted), or in a less formal way of revenue sharing via agreements to transfer technological and human know-how from foreign to local banks akin to the bank twinning program run by EBRD at the early stages of financial transition in the countries of eastern and central Europe and CIS in the 1990s.

### WINDOWS 'BEST OPTION' FOR SHORT-TERM GROWTH

The best option to achieve policy and developmental objectives in an efficient way, and develop viable Islamic banking in the short-term would be for Kazakh authorities to introduce Islamic banking windows in conventional banks.

The largest banks that may easily provide Islamic retail products for the population and SMEs across Kazakhstan should become the new players in Islamic banking. The experience of other countries shows that this is a very good way to exercise economies of scale and provide universal access to modern Islamic financial instruments.

Currently, Islamic financial institutions in Kazakhstan encounter numerous challenges in their everyday operations. To their credit, the authorities, in particular the National Bank of Kazakhstan, are committed to resolving them but the work and efforts should intensify

to provide a real impetus to Islamic banking and finance in Kazakhstan.

### MUST BUILD LEVEL PLAYING FIELD

In addition to introducing Islamic banking windows the current legislation should be amended to provide an equal treatment and a level playing field for the Islamic finance industry as compared with the conventional banking and finance industry. The most important and salient issues are as follows:

#### 1. Tax and regulatory treatment of Islamic financial instruments and products as financial services and products.

Presently only the Islamic financial instruments that are approved by legislation are treated as financial products. It takes time to amend legislation for every product. In the meantime Islamic financial intermediaries are taxed at the level of individual transactions since every transaction in Islamic banking involves purchase and sale of goods. This practice should be stopped.

The national legislation should permit purchase and sale of property, goods and commodities by Islamic banks, and treat it not as separate entrepreneurial activities but as financial transactions. Accordingly all Islamic financial instruments should have equal treatment with conventional financial instruments. This means:

- 1.1 No taxation of individual Islamic banking operations or financial instruments. Instead taxation should be done at the level of Islamic financial institution as profit centers as it is done with conventional financial institutions.

1.2 Overall tax regime for Islamic financial institutions should be harmonized and brought on equal terms with the tax regime for conventional banks.

1.3 National Bank and Ministry of Finance of Kazakhstan should have the authority to approve or change Islamic financial instruments by internal regulation and not by amending national legislation every time.

1.4 The usual property rights registration mechanism for Islamic financial instruments should be substantially streamlined allowing fast track procedures for registration of underlying property and assets of Islamic financial instruments.

1.5 Islamic mortgage and leasing should have the same tax and regulatory regime as traditional mortgage and leasing.

## **2. Amending legislation for government and quasi-government corporates to allow for Islamic banking instruments.**

At the present time, government-owned or controlled corporates find it hard to finance their operations using Islamic banking products however competitive they may be priced. Since Islamic banking involves purchase and sale of goods, the Islamic banks have to pass through government tender and procurement procedures. In addition the natural monopolies are not allowed to purchase certain goods at all. This puts Islamic banks at a disadvantage vis-à-vis conventional banks that do not have to go through the procedures. There will be no real take-off of large scale corporate Islamic banking until the legislation is amended to provide for Islamic

banks to compete on equal footing with conventional banks for large corporate clients.

**3. Developing liquid and deep internal market in local currency tenge for Islamic financial institutions.** There is no domestic market in tenge for Islamic financial institutions. They are not allowed to use traditional financial instruments, and there is a lack of Shariah-compliant liquidity instruments. This is one of the major impediments to developing Islamic finance tenge denominated products.

**4. Amending and streamlining legislation for sukuk issuance in Kazakhstan.** In particular, legislation should allow for issuance of asset-based sukuk, and listing and registration of sukuk at the Kazakhstan Stock Exchange (KASE). The KASE listing and registration procedures should allow for equal treatment of Islamic and conventional financial instruments. It should also be possible to register and list sukuk issued in other domiciles for purchase by domestic investors.

**5. Amending the legislation to allow for issuance of fixed fee and covered Islamic banking cards.** Presently Islamic banks are unable to issue Shariah-compliant Islamic banking cards, as there are numerous tax and regulatory implications. Developing retail Islamic banking products that form the underlying structure for Islamic banking cards will involve streamlining and amending the corresponding national legislation.

The above list may seem daunting at first glance. However most of the work is technical in nature. As Kazakhstan has made noticeable

progress by laying the foundations for the Islamic financial system it now needs to move forward rapidly on amending and harmonizing the national legislation with best international practices. This will help the country and its leadership to develop Kazakhstan as a regional leader in Islamic finance.

---

### **ENDNOTE**

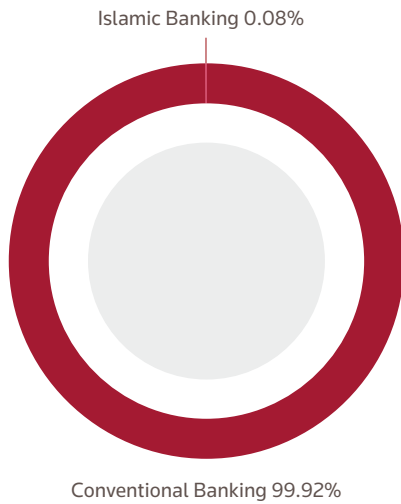
- 1 The banking statistics in the article comes from the National Banking of Kazakhstan.

# Islamic Banking Overview



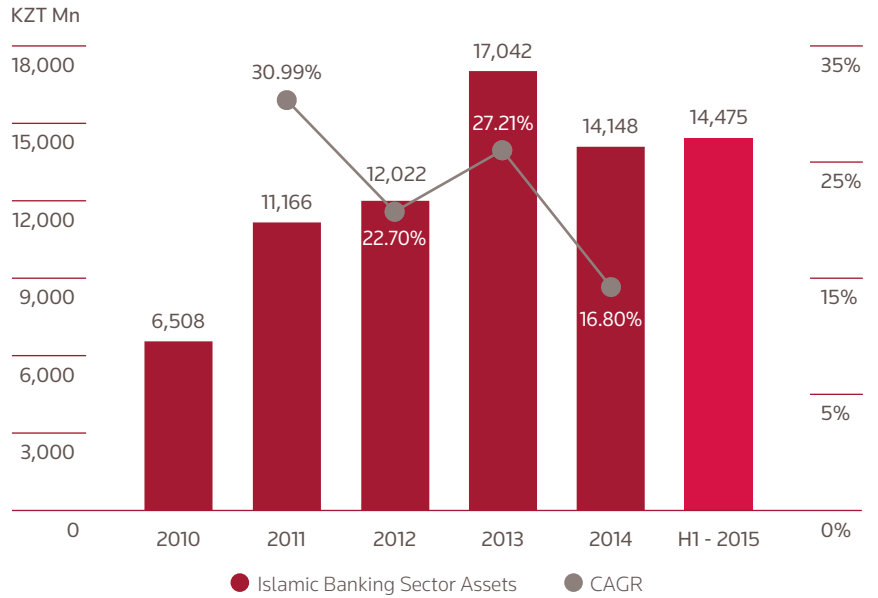


### KAZAKHSTAN BANKING SECTOR ASSETS – 2014



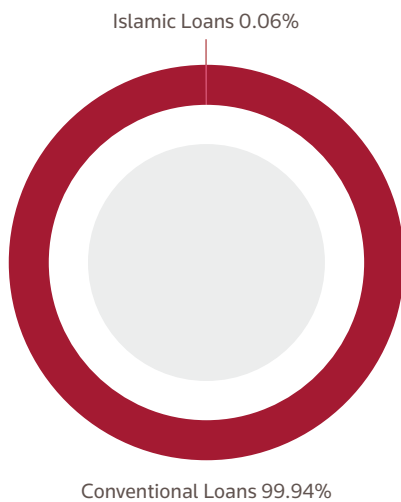
Source: Performance of Financial sector statistics, National Bank of Kazakhstan

### ISLAMIC BANKING ASSETS



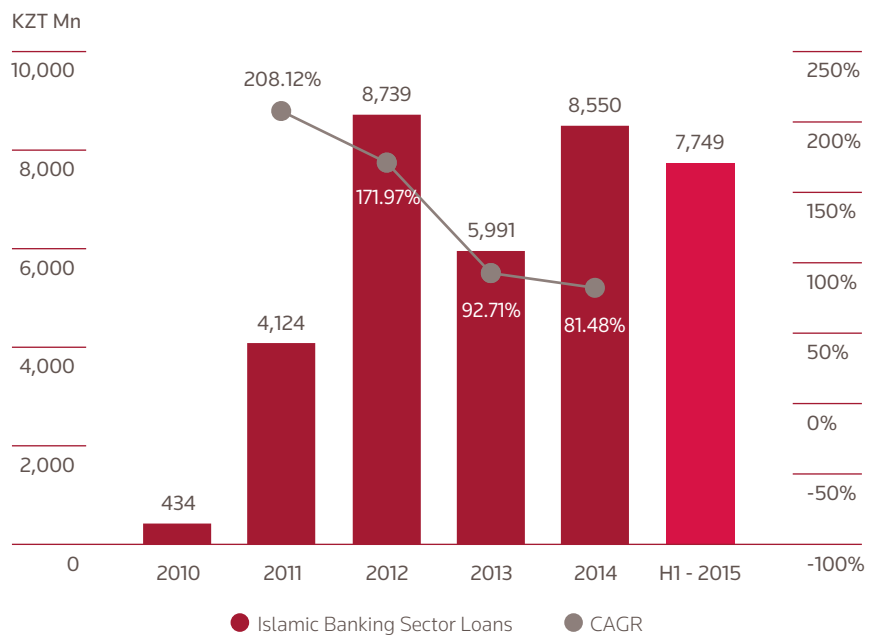
Source: Performance of Financial sector statistics, National Bank of Kazakhstan  
CAGR calculation is based on 2010 as it is the first year of operation for the only Islamic bank in Kazakhstan

### KAZAKHSTAN BANKING SECTOR LOANS – 2014



Source: Performance of Financial sector statistics, National Bank of Kazakhstan

### ISLAMIC BANKING LOANS



Source: Performance of Financial sector statistics, National Bank of Kazakhstan  
CAGR calculation is based on 2010 as it is the first year of operation for the only Islamic bank in Kazakhstan

Note: All year end data are based on January 1st of the next year

## Islamic banking in Kazakhstan: still at introductory stage



Kazakhstan was the first CIS country to introduce Islamic finance legislation, in 2009, and Islamic banking in the country is still very much at the introductory stage. The

share of Islamic banking assets accounts for less than 1% (only 0.08%) of total banking sector assets. However, this percentage is expected to reach 3%-5% in 2020 according to the Conception of the Financial Sector Development of the republic of Kazakhstan till 2030. The Kazakh Islamic banking sector is represented by only one Islamic bank, which is Al Hilal Islamic Bank. The total assets value in 2014 was USD 77.42 (KZT

14,148) million compared to a higher USD 110.45 (KZT 17,042) million in 2013. Total Islamic banking assets recovered in 2015 and reached USD 77.77 (KZT 14,475) million by June, surpassing 2014's level.

The slow growth in Kazakhstan's Islamic banking sector can be attributed to certain issues mainly with regards to the country's current Islamic banking regulations. However, the CIS region represents a substantial untapped potential for Islamic finance, given the region's economic growth, favourable demographics and a nascent financial sector.



THE KAZAKH ISLAMIC BANKING SECTOR  
IS REPRESENTED BY ONLY ONE  
ISLAMIC BANK, WHICH IS  
AL HILAL ISLAMIC BANK. THE TOTAL  
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USD 77.42 (KZT 14,148) MILLION  
COMPARED TO A HIGHER  
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01

### Harnessing existing Islamic banking legislations

- The new amendment introduced a new product “Tawarruq” as opposed to “cash financing” in the conventional banking system.
- This should be used and offered to attract customers with conventional mindset such as: (1) Local retail and corporate customers, (2) Foreign financial relationships with other financial institutions, especially in neighbouring countries where there is a lack of Islamic banking offerings.

02

### Easing restrictions on Islamic banking

- Islamic windows are yet not allowed in Kazakhstan. The frontier market needs more relaxed guidelines to establish Islamic finance and move forward.
- If allowed, this would: (1) Encourage existing conventional market players to offer Islamic banking products. (2) Attract foreign banks with established Islamic windows.
- The Islamic banking law in Kazakhstan required that the name of the Islamic Bank should include the words “Islamic Bank”.
- If alleviated, this would: (1) Further develop Islamic banking if it is promoted to be an “ethical approach” of financing. (2) Which in turn, could attract a wider customer base.
- It is proposed by the National Bank of Kazakhstan that the capital requirements for Islamic banks to be reduced from KZT 10 billion to KZT 5 billion for foreign and local investors.
- If applied, this would (1) Encourage existing conventional players to convert their licenses into Islamic (2) Attract foreign market players to tap Kazakhstan’s Islamic banking market.

Kazakhstan’s potential is as a leader in Islamic finance for the Central Asian region where further development can be achieved through:

03

### Raising awareness about Islamic finance

- With Kazakhstan’s intention to develop its Islamic finance sector, education must play an integral part. In this regard, Governmental efforts should be devoted towards: (1) Encouraging universities/ institutes to offer Islamic finance degrees/ courses. (2) Arranging conferences/ seminars about Islamic finance for the business community. (3) Enhancing collaboration with international educational bodies.

04

### Capturing the untapped potential for SMEs

- Kazakhstan is shifting its strategy from big enterprises development to SMEs development as a driver of its economy. SMEs represent the future growth and employment of any country and an essential foundation for shared prosperity.
- Islamic finance in Kazakhstan can grasp the opportunities in supporting SMEs development through: (1) Establishing a framework to facilitate Islamic financing for SMEs that would encourage the creation of an Islamic SME bank. (2) Liaison between public and private sector in terms of SMEs funding, such as establishing a dedicated Islamic SME fund.

05

### Linking Kazakhstan’s infrastructure development to Islamic financing

- With the government’s intention to further develop Islamic finance, infrastructure projects could be financed through Islamic financing instruments. This could be further achieved through enhancing public-private partnership, which will: (1) Encourage existing market players to enter the Islamic finance space (2) Encourage foreign investors to collaborate with the government in financing such projects.



# PRASAD ABRAHAM

Chief Executive Officer and Chairman, Al-Hilal Bank Kazakhstan



**PRASAD ABRAHAM's** banking career started in 1977 when he joined Citibank, after which he joined Arab Banking Corporation (ABC) in Bahrain in 1983. At ABC, he was Group Chief Auditor until 2003, serving on the Audit Committee of the parent company, and also the Audit Committees of Banco Atlantico in Spain, ABC Daus in Frankfurt, and ABC International Bank in the UK.

In 2004 Prasad was appointed as the Deputy CEO of ABC International Bank in London, which was the Holding Company for ABC's European operations. During the second half of 2007, Prasad was involved in coordination and pre-opening efforts to establish Al Hilal Bank in Abu Dhabi. When the Bank was formally opened in June 2008, Prasad was appointed as the Chief Operating Officer before his appointment as CEO at the newly-established Al Hilal Bank Kazakhstan.

**1. Kazakhstan's legislation of Islamic law which was passed in 2009 is a historic move for CIS region, making Kazakhstan to be the 1st among the CIS countries to have such legislation passed by the government. In your opinion, what do you think led to such move?**

The Global financial crisis of 2007-2008 had a great negative impact on Kazakhstan's economy, especially in respect of access to financial resources on international market. In order to diversify its financing resources it was needed to find additional alternative channels of raising funds. In this situation Arab countries with their intention to invest and their financing schemes, which was not suffered from the crisis so deeply, seemed as a good opportunity for diversification. But in order to make the financing schemes viable in Kazakhstan's reality it was needed to improve legislation. So, I think it was the main reason for such move.

The establishment of an Islamic Bank infrastructure will also fulfill an

important social need. Kazakhstan has a large market population and the vast majority of them individuals are looking for an ethically acceptable solution to meet their financial needs.

**2. As a result of introduction of this new legislation, what has been the reaction of Kazakhstan financial industry and acceptance level of its players to this new development?**

The financial industry is watching the growth of Islamic finance with cautious interest. There were some initial concerns that the Islamic finance industry would grow rapidly and cannibalize the market of conventional players. But now the industry has seen that both Islamic and conventional banks can work side by side and enjoy complementary growth. Many local banks have approached us to seek assistance in structuring Islamic products for their clients so definitely there is interest in the alternate financing avenue.

**3. Due to the release of such legislation, Kazakhstan has witnessed a full fledged Islamic bank; Al Hilal Bank of UAE and Takaful Halal Insurance have come on board, both in year 2010. Nonetheless, ever since of its debut (10 year), there is no further setting up incidences, neither from Islamic banking industry nor from takaful, except these two. Being the sole market player, what do you think that hinders the growth of Islamic finance service industry in Kazakhstan?**

The growth pattern has to be viewed in the context of the global financial and economic landscape. Since the financial crisis of 2008, most Central Banks have introduced strict regulations regarding Capital and liquidity requirements. This means that many European and North American banks were focused on shrinking their balance sheets and preserving their capital adequacy ratios. Many gulf banks were focusing on their own markets where growth opportunities were more promising. Additionally, it has to be stated that although an Islamic Banking law had been introduced, it still needed a significant level of fine tuning to facilitate a smooth working structure. The Central Bank and the various regulatory authorities are aware of them and are actively working to introduce the necessary legislative amendments to facilitate this transition.

It should also be noted that in most other countries including the GCC, Malaysia and Turkey, there was a long gestation period after the initial introduction of Islamic Banking. After a while additional participants entered the scene and there was exponential growth. We expect

that the Kazakhstan experience will be similar.

**4. How do you evaluate the legal framework that governs banks/ Islamic banks? And where do you see the gap (if any) in that framework?**

It's much improved in comparison with the legislation in back 2009 when the first Islamic legal initiatives have been presented. However it still needs certain amendments in order to allow Islamic financing step further and be more competitive to the conventional schemes. The gaps still present in the taxation. For example, in the scheme of Ijara for individuals, there is an issue with VAT tax, because this Ijara is not treated equally to financial lease.

Additionally, the current Islamic Banking legislation contains a limited list of Islamic products which are authorized. Under the current practice all new products have to be approved by parliament, which takes long time.

There are some legal implications regarding registration of ownership rights in the Islamic financing schemes. For example when Islamic bank engages in commercial activities as a commercial agent (Goods Murabaha), Islamic bank acquires the property, and then sells it to the client at a premium on deferred payment terms. In accordance with applicable law, some types of property require registration. At the same time, in such transactions of Islamic banks, registration seriously complicates the deal, since it requires additional cost, time, and possible tax liabilities.

One of the most popular products of Islamic finance to individuals is

financing the purchase of real estate (mortgage financing). In accordance with the principles of such financing, the Islamic bank purchases the property (becomes an owner) and transfers it to an individual under a lease with subsequent transfer of ownership rights. Taking into account that during the rental period the property is owned by the Islamic Bank (i.e. legal entity), the calculation of the property tax will be based on the tax rates for legal entities (1.5% of the tax base compared to 0.05% to 0.2% for retail customers). This, in turn, puts the Islamic Bank in a position where it will be forced to shift these costs to the customer, increasing the cost of its products. Otherwise the bank will have to bear the costs on its own account.

Above that there is a legal impediment to develop Sukuk market. In accordance with currently applicable law, the issuance of Islamic securities implies mandatory transfer of ownership of the underlying assets to Islamic special purpose vehicle, which will be the issuer. Thus, the originator cannot participate in issuing of Islamic securities without actual transfer of assets. In international practice, this type of Sukuk is referred to Asset-backed Sukuk.

This type of Sukuk may not attract much interest among state-owned companies, due to certain restrictions and implications regarding the rules on transfer of property from state-owned companies to third parties. Therefore, the Sukuk market in Kazakhstan is virtually closed for them.

However, it should be noted that in the international market there is also



THE REGULATORS SHOULD FOCUS ON ELIMINATION OF LEGISLATIVE BARRIERS AND IMPROVE OF THE PERCEPTION OF THE ISLAMIC PRODUCT BY THE MARKET. WE ARE NOT ASKING FOR SPECIAL PRIVILEGES. WE WOULD LIKE TO SEE A “LEVEL PLAYING FIELD” WHERE ISLAMIC BANKS ARE TREATED IN THE SAME WAY AS CONVENTIONAL BANKS.

another kind of Islamic securities — Asset-based Sukuk. Asset based sukuk are currently more popular than Asset-backed Sukuk, largely because they do not require actual transfer of assets from the originator.

Legislative recognition of Asset-based Sukuk in Kazakhstan will allow state companies to tap this attractive market without complete disposal of control over the underlying assets.

**5. Based on the 2009 Islamic legal framework, and taking into consideration of current and future development of Islamic finance service industry, what would be issues that the regulators should address while amending such framework?**

The regulators should focus on elimination of legislative barriers and improve of the perception of the Islamic product by the market. We are not asking for special privileges. We would like to see a “level playing field” where Islamic banks are treated in the same way as conventional Banks.

**6. Having such fact stated in no 3, do you see Islamic finance to be**

**potentially in demand and viable to banking and finance customers of Kazakhstan, and why?**

We have witnessed the strongest demand from the retail sector. Most of the interest stems from religious beliefs, but there are also underlying economic misconceptions. Many people believe that Islamic finance means “free” banking. We believe that if the existing legislative restrictions are streamlined, we would be able to after a broad spectrum of competitive products to the market, which would result in greater penetration of the market, which in turn would result in increasing the general awareness of Islamic financing principles.

**7. Al Hilal, being the sole player of Islamic banking industry of Kazakhstan where it offers banking products and services strictly only for Wholesale customers. What stops Al Hilal from offering its products and services to retail consumers?**

We are aware of the keen interest from the Retail sector. The main difference is that in the corporate sector, even if there are certain ambiguities in the legislation, we

would be able to discuss these with financially literate counterparties, and once the underlying issues were fully understood, we would proceed with the transactions. In retail, the reputational risk from perceived misunderstanding could be quite high. So we have to tread cautiously before we engage this sector. It should be stated that we have now engaged one of the Big 4 firms to perform a detailed study about the feasibility of introducing retail products in the local market.

**8. Given the fact that Muslims are the largest by population in Kazakhstan, how do you assess the public awareness about Islamic banking? On a scale of 1 (highly aware) to 10 (no clue), what rate of scale would you rate on their awareness on Islamic banking and finance?**

Base on the above rate, what lead to such rating and what do you suggest to further increase the awareness of Kazakhstan people on Islamic finance.

The level of awareness is generally on the low side. I would assign a numeric rating of 7. As the first Islamic Bank we recognize our

responsibility in raising awareness. Every 6 months our Shariah advisor conducts a series of lectures across a broad spectrum of society. These include university students (who will be tomorrow's CFOs), university lecturers, Regulators, Corporate CEOs and CFOs, and also local imams. The imams are supposed to understand the principles and in turn educate their constituent populations.

**9. In your point of view, comparing to the current rate with conventional bank, what would be the growth rate of Islamic finance if potential business and retail clients will opt for Islamic Finance once they are widely offered?**

In terms of actual growth rates, Al Hilal has witnessed much stronger growth in percentage terms when compared to our conventional counterparts, but this is largely because we started from a "zero base". Until we reach critical mass, our growth pattern will be above the market average. Once we introduce retail, we will definitely see a boost in volumes.

**10. How would you assess the current banking sector in Kazakhstan, given that it is currently dominated by few market players?**

The top six banks represent approximately 70% of the banking market. This is not very different from the trend seen in many developing markets. We do not foresee major changes in the structure in the near future. As long as the economy enjoys strong growth, there will be increasing opportunities for all participants.

**11. How do you see Islamic finance service industry in Kazakhstan in the next 5 years from now?**

The National Bank is considering the possibility of authorizing the creation of "Islamic Windows". This will allow many banks to introduce Islamic banking activities without having to create separate full-fledged subsidiaries. Such actions will result in significant increase in volumes. We also see at least two potential new Islamic Banks coming to the market in the next two years. As mentioned previously, once there are two or three participants, it is no longer a concept. This becomes a proven economic model and then you witness a rapid growth trajectory.

**12. With the current development of Islamic finance in Kazakhstan such as amendment of Islamic finance legislation, do you see Kazakhstan has the potential to become the hub of Islamic finance for CIS region in the coming years and if yes, why?**

If not, what would be the enabling factor for the regulator to seriously consider in order enabling Kazakhstan to become a regional hub of CIS countries on Islamic finance?

Kazakhstan definitely has taken the lead in establishing the foundation for Islamic finance in CIS. This has given the country a clear advantage in becoming the regional hub. Additionally, this initiative has the strong endorsement of the President which should act as a catalyst towards achieving this goal.

# 4 Islamic Banking Growth Prospects



Fountain show in the  
Astana, Kazakhstan.



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## Survey Methodology

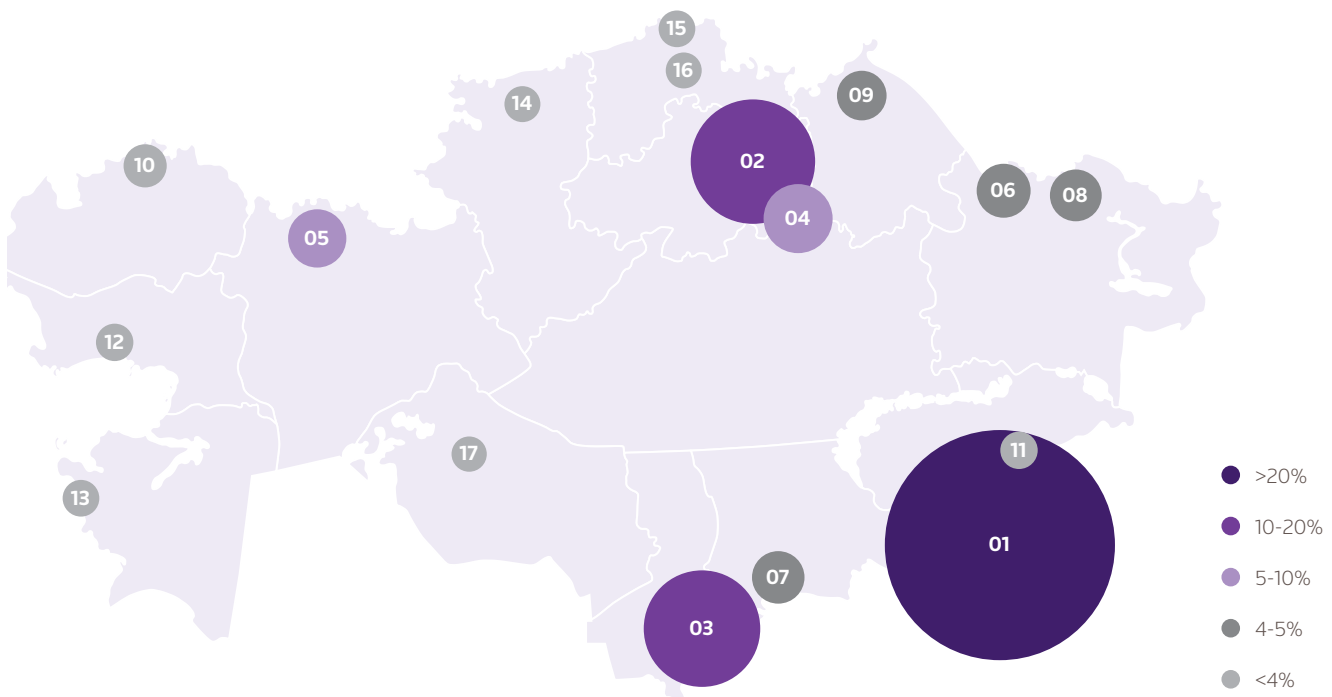
The consumer financial services survey was conducted in July 2015 in collaboration with National bank of Kazakhstan. The survey was distributed to a sample of Kazakhstan’s residents over 18 years old. Apart from

responses to the survey questions, we also gathered economic and demographic data about respondents’ age, gender, religion, educational level, place of residence, occupation and monthly family income.

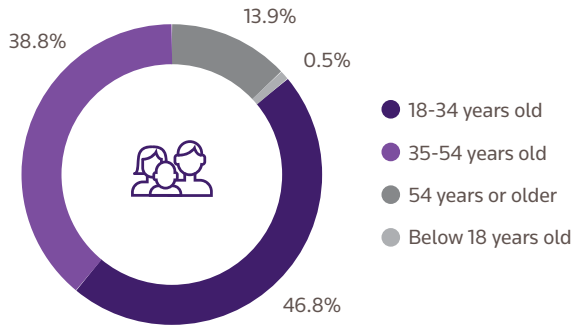


SAMPLE SIZE 1,557

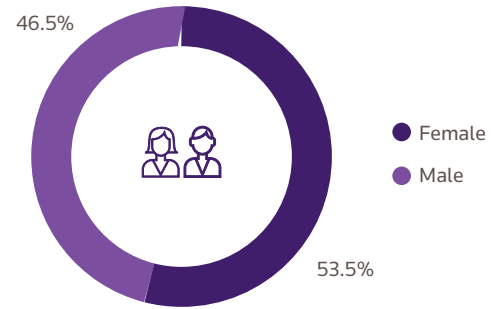
<b>#10</b> <b>URALSK</b> 3.9% (60)	<b>#05</b> <b>AKTOBE</b> 5.3% (81)	<b>#15</b> <b>PETROPAVLOVSK</b> 3.3% (51)	<b>#09</b> <b>PAVLODAR</b> 4.5% (69)	<b>#11</b> <b>TALDYKORGAN</b> 3.4% (52)
<b>#12</b> <b>ATYRAU</b> 3.4% (52)	<b>#14</b> <b>KOSTANAI</b> 3.3% (50)	<b>#16</b> <b>KOKSHETAU</b> 3.3% (50)	<b>#06</b> <b>SEMEY</b> 4.9% (75)	<b>#01</b> <b>ALMATY</b> 20.4% (312)
<b>#13</b> <b>AKTAU</b> 3.3% (51)	<b>#17</b> <b>KYZYLORDA</b> 3.2% (49)	<b>#02</b> <b>ASTANA</b> 11.3% (173)	<b>#08</b> <b>UST-KAMENOGORSK</b> 4.7% (72)	<b>#07</b> <b>TARAZ</b> 4.8% (73)
	<b>#03</b> <b>SHYMKENT</b> 10.6% (162)	<b>#04</b> <b>KARAGANDA</b> 6.3% (96)		



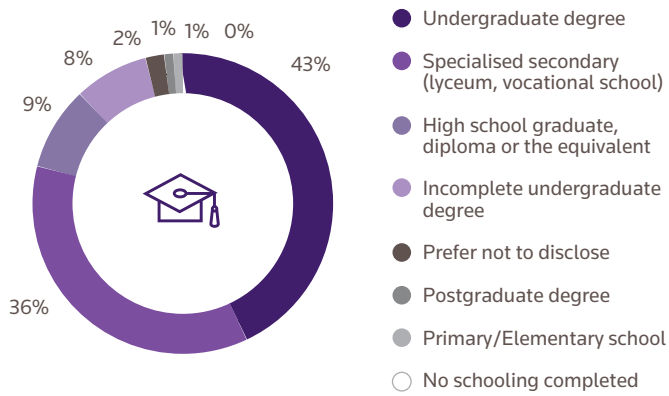
## AGE DISTRIBUTION



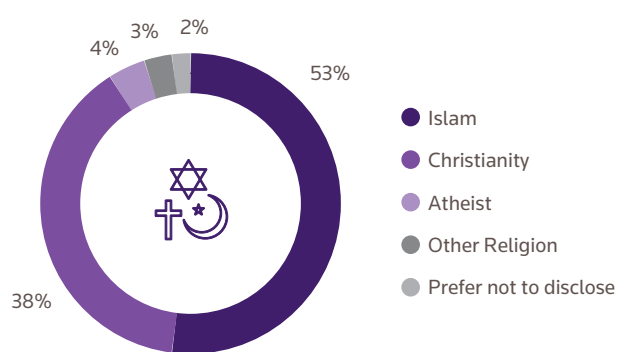
## RESPONDENT'S GENDER



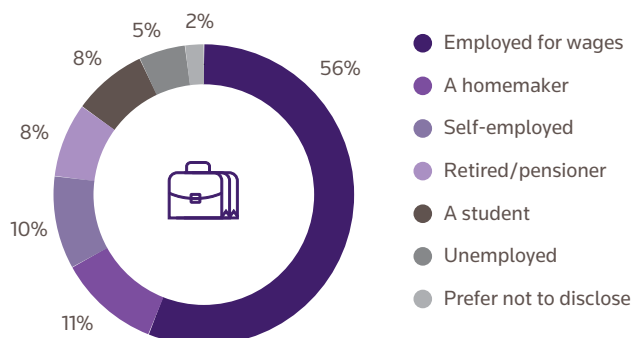
## HIGHEST LEVEL OF EDUCATION



## RELIGIOUS AFFILIATION OR SPIRITUAL BELIEF SYSTEM

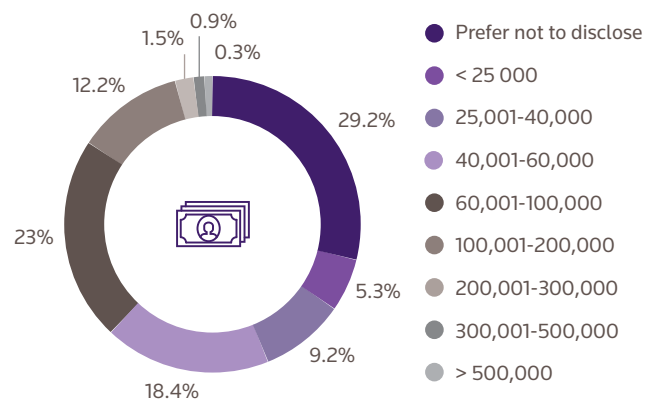


## EMPLOYMENT STATUS



## INDIVIDUAL MONTHLY INCOME

(in Kazakhstani Tenge)





**ZAMAN-BANK**



**Time is not lent!**

**Уақыт қарызға берілмейді!**

**Время займа не дается!**

[www.zamanbank.kz](http://www.zamanbank.kz)

Our retail consumer banking survey have identified five growth strategies to prompt the growth of Islamic finance in Kazakhstan:



**Developing Awareness and Understanding**

Growth of Islamic finance in Kazakhstan is dependent on improving public awareness on Islamic finance



**Market Segmentation for Islamic Banking**

Market segmentation is an effective marketing practice in serving the Kazakh market and reach a wider customer base



**Enhancement of Customer Experience**

Customer-centricity strategy should provide customers the flexibility to customise products and services to fit their individual needs



**Leveraging Multi Banking Trends**

Bank must recongise that multi-banking is a natural way forward for the growth of the Islamic banking industry



**Unlocking Latent Opportunities**

High growth prospects for Takaful can further support the development of Islamic finance in Kazakhstan



# Developing Awareness and Understanding

GROWTH OF ISLAMIC

FINANCE IN KAZAKHSTAN

IS DEPENDENT ON IMPROVING

PUBLIC AWARENESS ON

ISLAMIC FINANCE

## Lack of understanding biggest hurdle to Islamic banking growth in Kazakhstan



The growth of Islamic finance is inherently linked to the growth of retail Islamic banking, which makes up almost 80% of global Islamic finance assets, according to the Thomson Reuters ICD Islamic Finance Development Indicator. It follows that countries that want to develop their domestic Islamic finance industries must integrate plans that address Islamic banking.

Too few stakeholders (either government or market players) in countries that are developing Islamic finance tackle the problems related to consumers' low level of awareness of Islamic banking products and their poor comprehen-

sion of the main differences between Islamic and conventional banking.

In fact, other Thomson Reuters Islamic finance consumer surveys conducted for Tunisia, Morocco, Turkey and Oman show that, to varying degrees, Islamic finance is both poorly understood and perceived negatively. The general public sees no difference between Islamic and conventional banking, and some even misbelieve Islamic banking to be a 'fraudulent' system. This misconception underlines the seriousness of the issue and the level of risk for the development of Islamic finance.

Countries of the Commonwealth of Independent States (CIS) face the same issues, particularly the Republic of Kazakhstan.

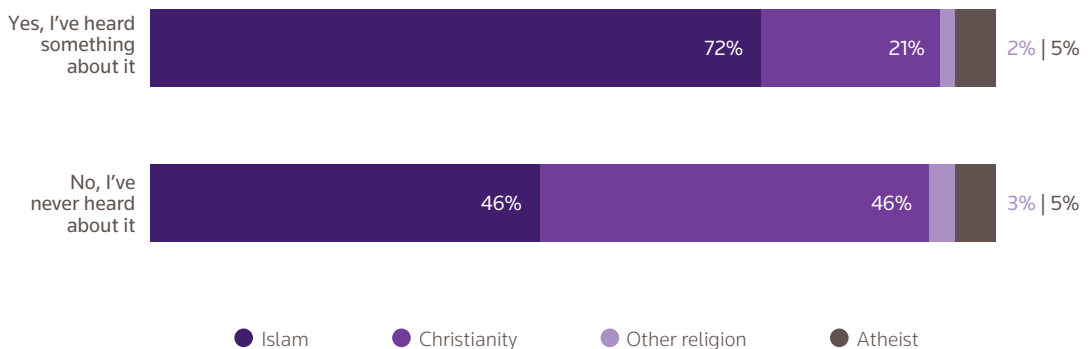
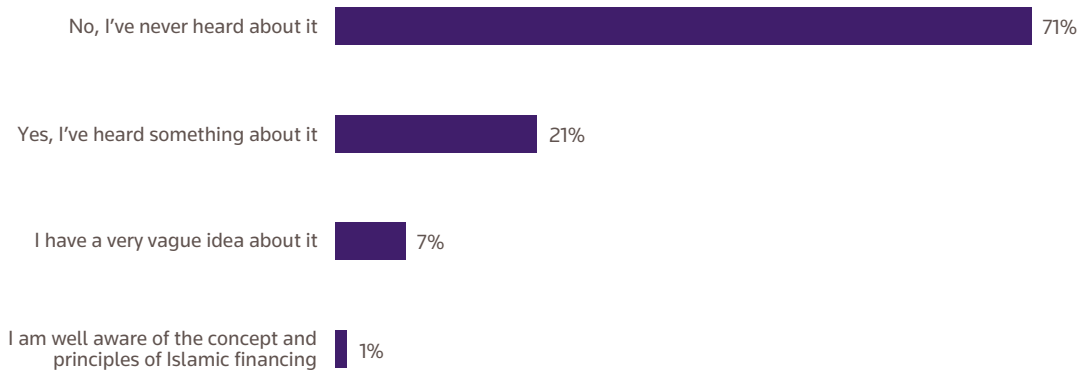
## 71% of surveyed Kazakhs say they have never heard of Islamic banking

Most survey respondents say they have never heard of Islamic banking/finance. This lack of awareness might be understandable in countries without a Muslim majority however, among the 17 million population of Kazakhstan, approximately 70% are Muslims. Those who have not even heard of Islamic finance are predominantly Muslims (46%) and Christians (46%). This lack

of awareness by Muslims may also be attributed to the prevention of practicing religion under communist USSR rule until 1991, whose impacts remain until today.

A much lower 21% of survey respondents have heard of Islamic finance, most of whom are Muslims.

### ARE YOU AWARE OF ISLAMIC BANKING/FINANCE?





## Kazakhstan would be receptive to Islamic banking if they understood it better

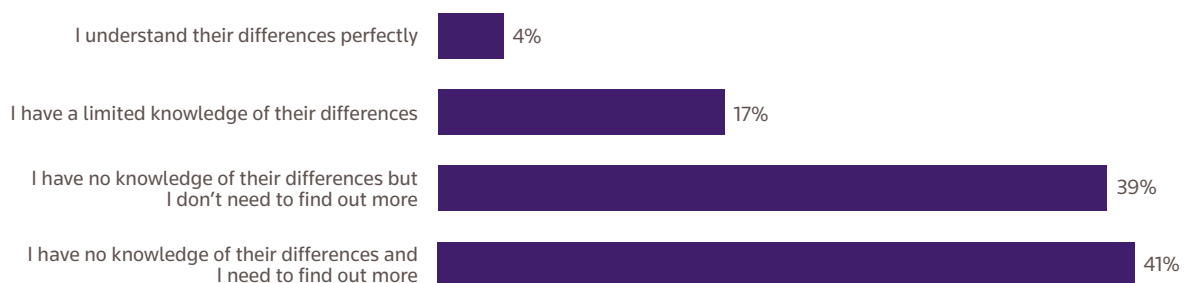
Among survey respondents, 41% do not understand the differences between conventional and Islamic banking but are open to find out more. Another 39% say that they don't need to know any more.

The need for greater awareness and understanding of Islamic banking and the broader Shariah-compliant financial industry is more evident than ever – especially since the majority of Kazakhs are receptive and open to learning more about the industry.

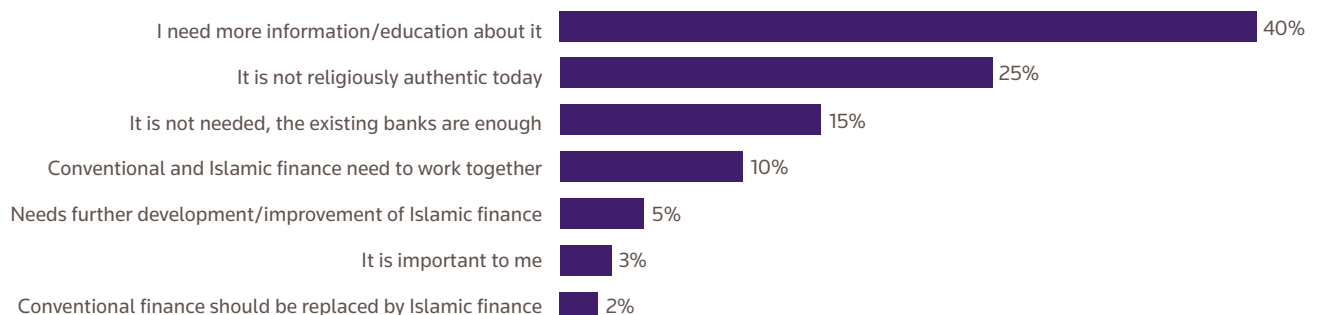
Responding to another question, 40% say they need more information and education about Islamic finance but 25% think Islamic finance is not religiously authentic.

The perception that Islamic finance is “inauthentic” may be due to a lack of understanding of how Islamic finance works. However, it cannot be claimed as a causal factor, particularly when most respondents have ‘not even heard of’ Islamic finance. This perception of inauthenticity is groundless and can be eliminated when understanding and education is improved.

### REGARDLESS OF THE LEVEL OF YOUR AWARENESS ABOUT ISLAMIC FINANCING, WHAT IS YOUR LEVEL OF UNDERSTANDING OF THE DIFFERENCES BETWEEN ISLAMIC AND CONVENTIONAL FINANCIAL SERVICES PRODUCTS?



### WHICH OF THE FOLLOWING STATEMENTS BEST DESCRIBE YOUR ATTITUDE TOWARDS ISLAMIC FINANCING?

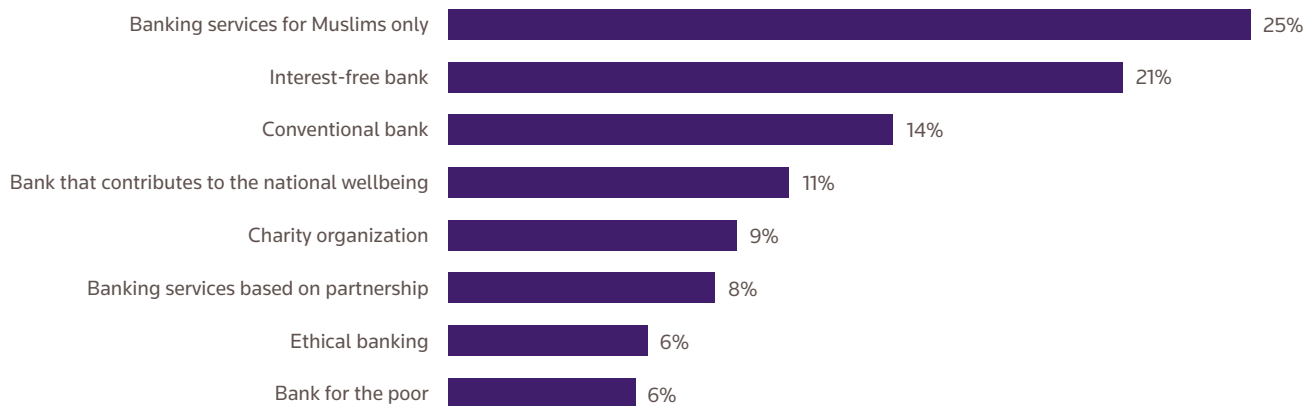


### 14% think that 'conventional bank' is part of Islamic finance

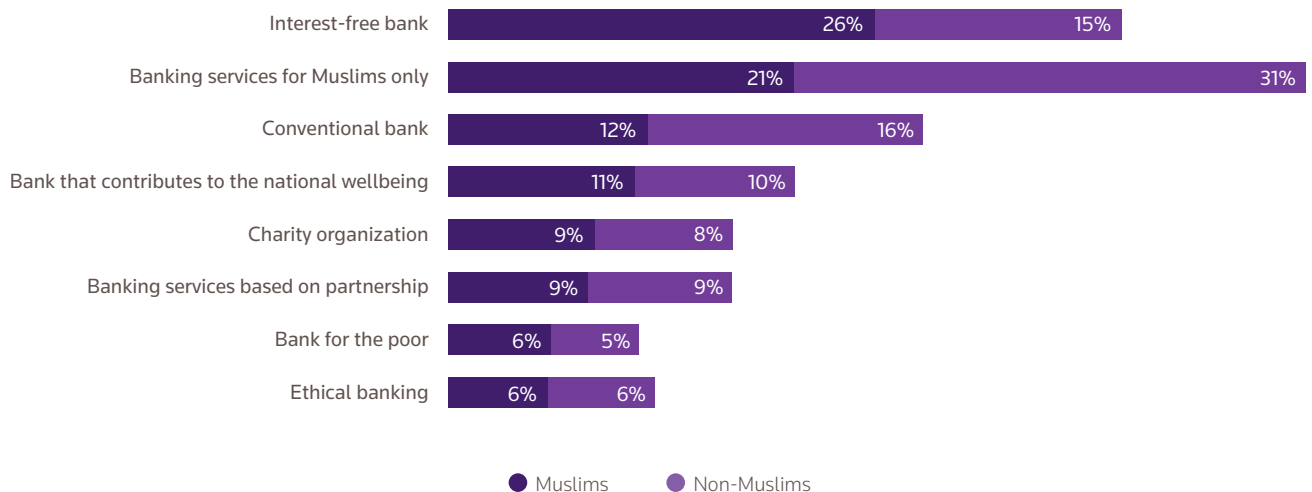
A quarter of respondents think Islamic finance is 'banking services for Muslims only', with a close 21% saying that it is 'interest-free' banking. How-

ever, 14% go so far as to think that 'conventional bank' relates to Islamic finance.

### CHOOSE THE ATTRIBUTES THAT, IN YOUR OPINION, RELATE TO ISLAMIC FINANCE



### FILTERED BY RELIGION



## **A national-level education plan, involving both the public and private sectors, is imperative to the development of Islamic finance in Kazakhstan**

Understanding, awareness and education is fundamental to the development of any industry in the consumer or corporate sector. Islamic finance is no different.

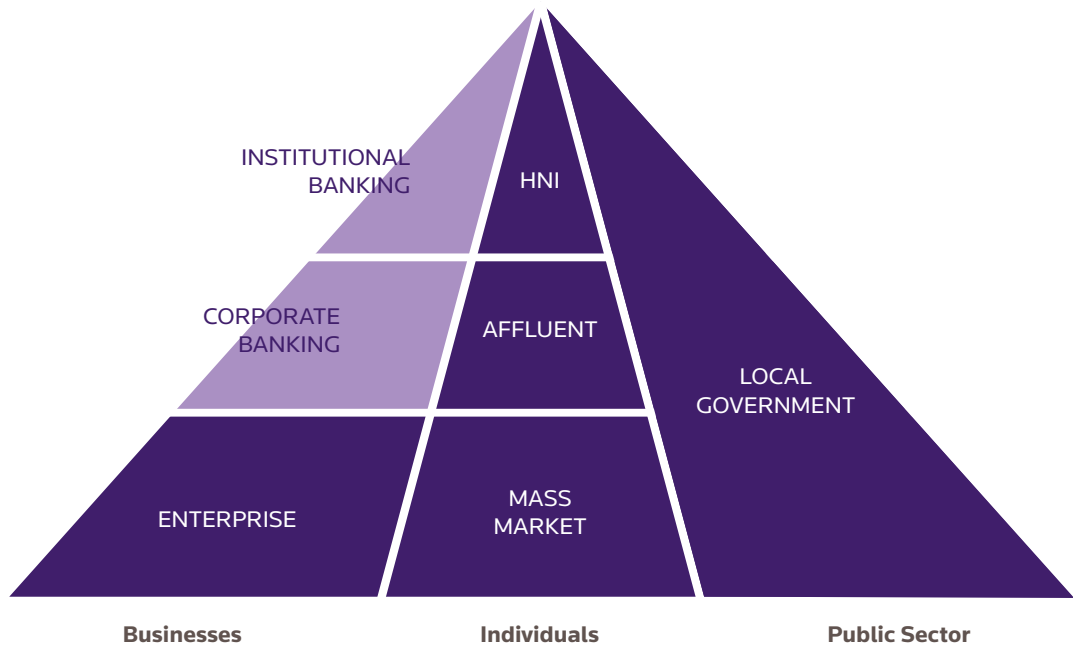
Unless consumers understand the concept of Islamic finance, there will be no demand for it. Similarly, Islamic financial institutions are unlikely to operate without the human resources and talent capable of running the day-to-day Islamic finance business.

Banking is the main driver of Islamic finance in most countries with large Shariah-compliant financial industries, including Malaysia, Bahrain

and Saudi Arabia. This does not discount other sectors such as the Islamic capital market. On the contrary, the Islamic financial ecosystem is inter-connected and building the Islamic banking sector is likely to jumpstart other segments.

The Republic of Kazakhstan would need to develop a plan to improve the level of understanding of Islamic finance across the country's socio-political spectrum, from special function departments in public institutions e.g. the Ministry of Finance, to private citizens such as professionals working in non-financial sectors, students and homemakers.

### The important three



Businesses, individuals and the public sector all play important roles in developing Islamic finance, banking in particular. Any educational, learning and vocational plan developed by

any of the major players in the industry, government or private, should address all three groups. These plans can incorporate, but are not limited to, the following:

- 1 Dedicated degree programmes (Diplomas, Bachelors, Masters, and PhDs)
- 2 Courses within a degree programme (electives, compulsory modules or subjects)
- 3 Topics in finance-related subjects or modules
- 4 Diplomas or independent short courses (non-degree)
- 5 Professional certification
- 6 Training and vocational courses
- 7 Public or private conferences, seminars, workshops and awareness programmes
- 8 Research studies and papers

# Advocacy on behalf of individuals lies entirely with the banks

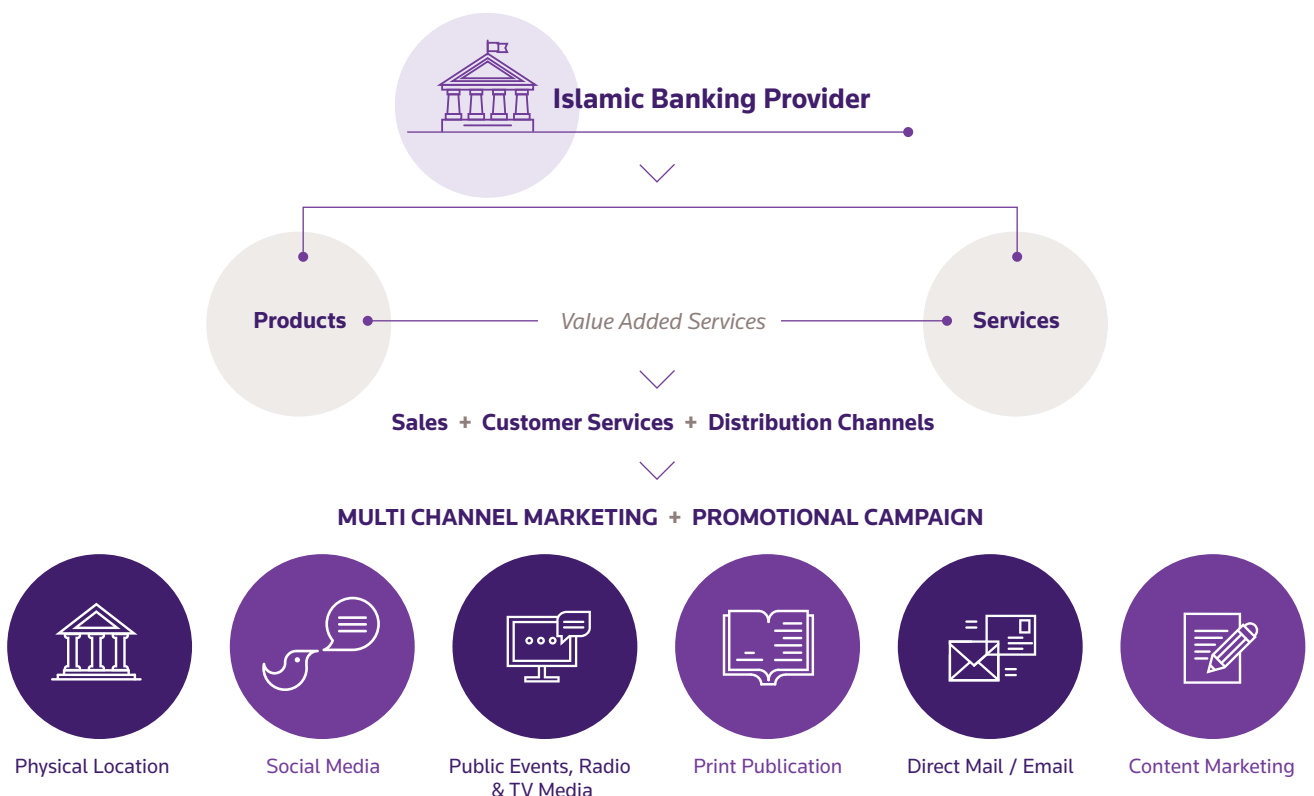
The public and private sectors (financial or otherwise) must provide their employees with training to help them operate Islamic finance-related functions. Private individuals could be drawn to use Islamic banking through different means. Banks are the first and last point of contact between consumers and banking services. The diagram below depicts a bank-wide plan for breaking the awareness/understanding barrier in Kazakhstan.

Designing a widespread marketing campaign is dependent on the services and products, the quality of services and, most importantly, the valued-added services for today's rapidly changing customer behaviour. Without these factors, any efforts taken to educate and improve the under-

standing and awareness of the public on Islamic finance may be ineffective.

The second part of the survey analysis addresses these points. Adopting a marketing campaign to promote Islamic banking products and services will project the value of Islamic banking to both Main and Wall Street and create an opportunity for an Islamic banking service provider to integrate plans to improve the concept of Islamic banking and finance in a broader sense.

This may include organising public workshops in universities for students (undergraduate or post-graduate), as well as running private workshops on technical Islamic finance concepts for the corporate sector. Suffice it to say, this would require a well-structured and well-monitored plan that includes relevant functions of the Islamic bank.





# NURPIISSOV ZARATKAZY

Chairman, Association for Development of Islamic Finance (ADIF)



**NURPIISSOV ZARATKAZY MANENGAZOVICH** is a Chairman of ADIF started 2015. He holds Bachelor and Master of Physics from Kazakh State University. Since November 1993 he worked as a leading specialist in the department of International Relations in the commercial bank "Kazmetall Bank".

In 2007, he became a member of the board of directors of the asset management company "Almaty Financial Center" was engaged in international investment issues and the start of the development of Islamic finance in Kazakhstan.

In 2009, he took part in issuing Islamic sukuk BNP Paribas pension funds of Kazakhstan market for amount – \$20 million. Also, he opened an asset management company JSC "Fattah finance". In the same year, Association of Development of Islamic finance (ADIF) started working as a professional organization for the development of the Islamic finance.

### **1. Kazakhstan's Islamic finance sector is still struggling to take off. Why has this been the case? How would you describe the current state of Islamic finance in Kazakhstan?**

Absence of legislation on IF, absence of specialists, literature, absence of financing from the side of Government in spite of support of President, mistrust to Kazakhstan from the side of large sign investors ((which are associated with the development of this market in Western countries) in connection with negative previous experience.

Currently, the Law, regulating the activities of Islamic banks, insurance and leasing companies was adopted. Coming soon the adoption of amendments to the legislation to allow banks to convert the traditional Islamic banks. Today, there is a support and desire of National Bank of the Republic of Kazakhstan to develop this branch.

There is a huge demand for Islamic financial instruments from business and the population. Individual banks appeal to us with an introduction request at itself separate Islamic tools. The program of training in Islamic finance "The expert of Islamic finance" in common of ADIF with RFCA Academy of National Bank is developed for business, banks and higher education institutions. Separate textbooks and brochures on Islamic finance are published Develop programs for further development of the industry.

### **2. What have been some of the key challenges that have held back the flourishing of Islamic finance in Kazakhstan?**

Problems:

- Absence of an united law on Islamic finance, which regulates the whole range of Islamic financial services.

- Previously, it was the absence Department of IF at the National Bank. It was started really to work only in 2014.
- Absence of financing from the state IF industry. Money is needed for the development of legislation, education of population, businesses and state employees.
- Absence of an united center of Islamic economics and finance, which have engaged in promotion, training and consulting IF. We suggested to create at ADIF as early as 2011.

### 3. Kazakhstan was the first former Soviet country to introduce Islamic finance rules but Islamic banking is still in its infancy. How can Islamic banking shape Kazakhstan's financial environment and what role it will play in the Republic's development?

Now in connection with the ongoing worldwide crisis in businessmen and the population gradually new judgment of their activity is growing. Business is trying to build new effective models. Separate banks and companies make a attention on Islamic finance as the tool which will be able to solve their problems. ADIF together with National Bank conducts master classes on training and an explanation of bases of Islamic finance in order to introduce them to these companies.

Release of sukuk in the future will allow to invest our money in infrastructure of Kazakhstan for the benefit of residents of the country by an example of other countries.

### 4. What do you see as the potential demand and viability of Islamic finance? What percentage of current and potential business and retail clients will opt for Islamic finance once the Kazakh market is more open for Islamic banks?

In the condition of full legislative demand for big IF – it is retail to the public, mortgage, SME, sukuk issue for large companies and the state. Growth will contribute to the increase of Muslims, as well as the adoption of the IF by the other confessions who are tired of traditional banks.

IF share achieve in the market in the Republic of Kazakhstan till 2020 y, - 5%.

### 5. Is there enough information and awareness about Islamic finance in the market? If not, what initiatives are in place to address this?

Practically there isn't any. No literature and experts. Recently ADIF with the Academy of RFCA of the National Bank launched a medium-term program "Specialist of Islamic Finance" for financial institutions, SMEs and universities. ADIF together with TV channel Asyl Arna has started the weekly program devoted to the development of Islamic finance in Kazakhstan. It must be supported by the National Bank and the IDB, as well as businessmen to take the program in 2016, after 5 years of the creation of the Center for Islamic Economics and Finance at ARIF who have engaged in propaganda IF, training and consulting.

### 6. What do you see as the necessary regulatory roadmap to move Islamic finance onto a level playing field vis-à-vis conventional players?

For this required:

- Resolution to open separate Islamic financial instruments "Islamic windows"
- Allow the conversion of conventional banks into Islamic.
- Make equal to traditional financial institutions tax burden Islamic organizations
- Reduce the requirement for capitalization of Islamic financial organizations
- To carry out training of personnel
- Organizing forums and summits for inviting foreign experts to exchange experiences and knowledge.
- Provide information support for Islamic financial organizations
- Open the government islamic bank and takaful company.



# Market Segmentation for Islamic Banking

MUSLIMS AND

MILLENNIALS ARE THE

FUTURE OF ISLAMIC BANKING





## Current consumer banking composition

### The growth of Islamic banking in Kazakhstan rests entirely on one provider



recently initiated.

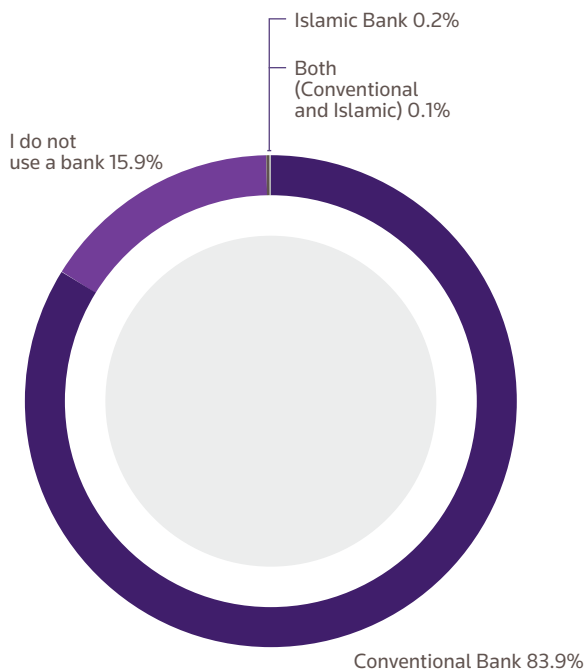
The small market share of Islamic banking in Kazakhstan can be attributed to two factors — that there is only one Islamic bank and that the industry was only

The majority of survey respondents (84%) build relationships with conventional banks and a much smaller proportion of respondents have any sort of relationship with Islamic banks

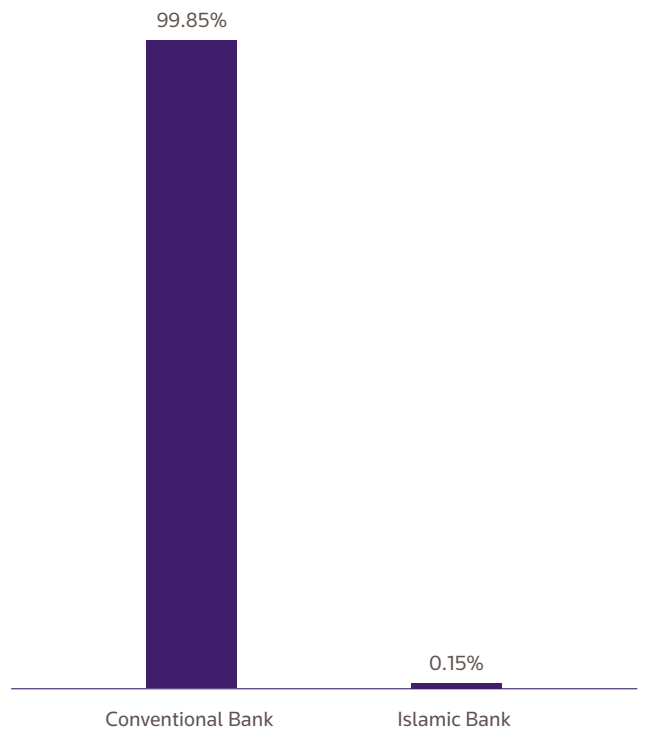
(0.1%). The current consumer banking environment is driven by conventional banks, and even Muslims — who are the most captive market for Islamic finance — bank conventionally (99.85%).

In such a niche market that is represented by only one Islamic banking services provider, customer-centric product development, a multi-platform marketing strategy and competitive pricing (relative to conventional banking) are amongst the key drivers to the growth of consumer Islamic banking.

WHAT TYPE OF BANKING SERVICE PROVIDERS DO YOU CURRENTLY USE?



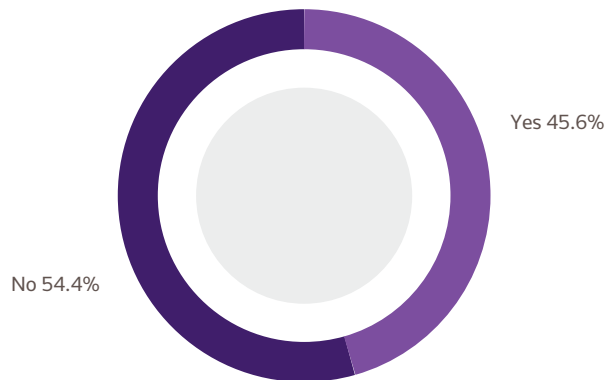
PERCENTAGE OF MUSLIM RESPONDENTS BY TYPE OF BANK



## Interest in Islamic banking

### Retail banking consumers in Kazakhstan have shown interest in Islamic banking, driven predominantly by Muslims and Millennials

WOULD YOU BE INTERESTED IN USING ISLAMIC BANKING SERVICES AND PRODUCTS?

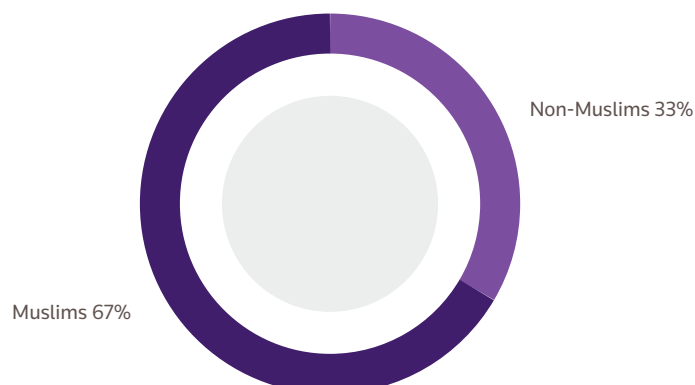


### Despite the low Islamic banking penetration in Kazakhstan, the Muslim market is a key growth driver

Almost half of survey respondents show interest in using Islamic banking products and services (45.6%). Muslims make up 67% of this group. In

a huge untapped market banks should **prioritise targeting Muslims** as a priority.

INTEREST IN USING ISLAMIC BANKING SERVICES AND PRODUCTS BY RELIGION





IN SUCH A NICHE MARKET THAT IS REPRESENTED BY ONLY ONE ISLAMIC BANKING SERVICES PROVIDER, CUSTOMER-CENTRIC PRODUCT DEVELOPMENT, A MULTI-PLATFORM MARKETING STRATEGY AND COMPETITIVE PRICING (RELATIVE TO CONVENTIONAL BANKING) ARE AMONGST THE KEY DRIVERS TO THE GROWTH OF CONSUMER ISLAMIC BANKING.

### Millennials are another target segment

As a group, Millennials and the middle-class groups are the other growth market segment that banks in Kazakhstan should be targeting; millennials ages 18-34 constitute 49% of total survey respondents and the youth dependency ratio 38.7% (CIA World Factbook 2014). Maintaining relationships with young consumers will

be the key driver for the future of Islamic banking. Developing customer-centric products for this segment is important. This may include new service lines including youth savings accounts, youth credit cards and educational savings and financing amongst other services.

### INTERESTE IN USING ISLAMIC BANKING SERVICES AND PRODUCTS BY AGE GROUP



## Islamic banking imperative growth factors

Islamic banking principles are ranked second after competitiveness and institutional stability



and strategies.

The survey revealed that the most important considerations and factors that will drive Islamic banking growth must be translated into a series of action plans

### Substance

Despite being ranked the fourth most important factor for dealing with an Islamic bank, this proves that most Muslims in Kazakhstan are sensitive to Shariah principles. If banks meet top criteria price and quality of services, Muslims would be more willing to deal with an Islamic bank.

### Competitiveness and Stability

Banks must focus on building trust and reputation as a key strategy, aligned with high quality of service delivery. Banks should invest in front-line staff to deliver better quality service; human resources development will play a vital role in enhancing quality and experience.

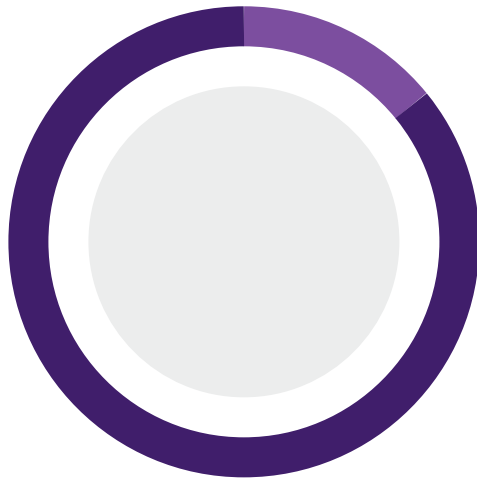
### Diversity and Convenience

At the national-level the National Bank of Kazakhstan has committed to widening the range of Islamic banking products. It is now the turn of current and potential market players to enhance product innovation with affordable and attractive packages that cater to consumers' needs.

## Potential consumers are likely to deal with a bank providing both Islamic and conventional banking services

WHAT TYPE OF BANK WOULD YOU BE INTERESTED IN DEALING WITH FOR ISLAMIC BANKING SERVICES?

A bank providing Islamic banking services only 14%



A bank providing both conventional and Islamic banking services 86%

Kazakhstan would prefer a bank that provides both conventional and Islamic banking services (86%); Islamic windows could do very well in this environment.

Islamic banking windows have enjoyed positive growth in most of the developed Islamic banking markets (and newer ones such as Oman) despite concerns regarding leakage and mingling of Islamic and non-Shariah-compliant funds (which led to a ban on Islamic windows in Qatar in 2012). Strict regulations and controls governing their operations will be key to ensuring the success of Islamic windows to maintain the integrity of Shariah principles.



## Suggestions of ways to mitigate the risk of commingling of funds

- Government action to enhance Shariah governance through moving to national-level central Shariah board which will create more transparent and secured market.
- Professional advanced training to be implemented to train qualified Shariah auditors, Shariah scholars as well as advisors to overcome concerns about funds commingling.
- Top conventional retail-focused banks should open windows operations quickly to capture the potential market by leveraging on their existing consumer relationships.

^ A cashier checks Kazakhstan's Tenge currency notes in a Eurasian Bank branch in Almaty. REUTERS/Shamil Zhumatov



# Enhancement of Customer Experience

BANKS

NEED TO IMPROVE

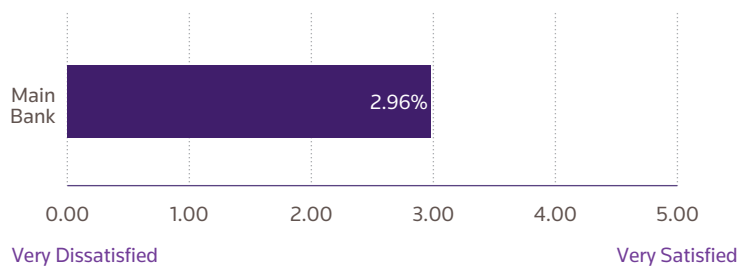
CUSTOMER EXPERIENCE

## Current level of (average) consumer satisfaction should provide Islamic banks impetus to lead the market



Measuring consumer satisfaction levels is imperative if banks want to improve and further develop the Islamic banking sector. Retail banking consumers say they enjoy an average level of satisfaction with their main banking services provider. This is an opportunity for new Islamic banks to exploit and capture but only if they can customise products and services to suit individual needs and at the least, stay competitive with conventional banks.

AVERAGE SATISFACTION LEVEL OF THE MAIN BANKING SERVICE PROVIDER



**Islamic banks must be able to transform negative consumer experiences into positive ones. Banks with Shariah mandates to start Islamic banking operations should devote their efforts into designing an effective strategy that tackles mainly four aspects:**



# Global Islamic Finance Advisors



## ABOUT US

Amanie Advisors is a leading Shariah advisory firm specializing in Islamic finance solutions covering a wide range of services including Shariah advisory and consultancy, training and research and development for institutional and corporate clientele focusing on Islamic financial services. Guided by its Shariah Supervisory Board, Amanie Advisors provides end-to-end Shariah solutions to the client through its offices around the globe.

Amanie Advisors has been established with the aim of addressing the global needs for experts' and Shariah scholars' pro-active input. This will ultimately allow the players in the industry to manage and achieve their business and financial goals in accordance with the Shariah Principles. Amanie Advisors also focuses on organizational aspect of the development of human capital in Islamic finance worldwide through providing updated quality learning embracing both local and global issues on Islamic financial products and services.

The company is led by Datuk Dr. Mohd Daud Bakar, a renowned global Shariah scholar and teamed by an active and established panel of consultants covering every aspect related to the Islamic banking and finance industry. With offices in Kuala Lumpur, Dubai, Luxembourg, Cairo, Melbourne, Astana, Muscat, Seoul, Dublin and Tunis; Amanie Advisors is in a position to offer both international and local perspectives through global practices to its clients.

### REGIONAL OFFICE: ASTANA, KAZAKHSTAN

Amanie Advisors has an office in Astana Kazakhstan, making it the premier global Islamic finance consultancy group with a local presence. Through its presence in strategic jurisdictions across the globe, Amanie is in a position to offer international perspective and global best practices to its clients in Kazakhstan and contribute towards the development of cross-border transactions into and out of Kazakhstan.

[www.amanieadvisors.com](http://www.amanieadvisors.com)

### Amanie Advisors International Shariah Supervisory Board

For clients seeking International Shariah endorsement, we provide the service through our international Shariah Supervisory Board. The board consists of the following esteemed Shariah scholars:

- Dr. Mohamed Ali Elgari  
Kingdom of Saudi Arabia
- Dr. Muhammad Amin Ali Qattan  
Kuwait
- Datuk Dr. Mohd Daud Bakar  
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- Dr. Osama Al Dereai  
Qatar

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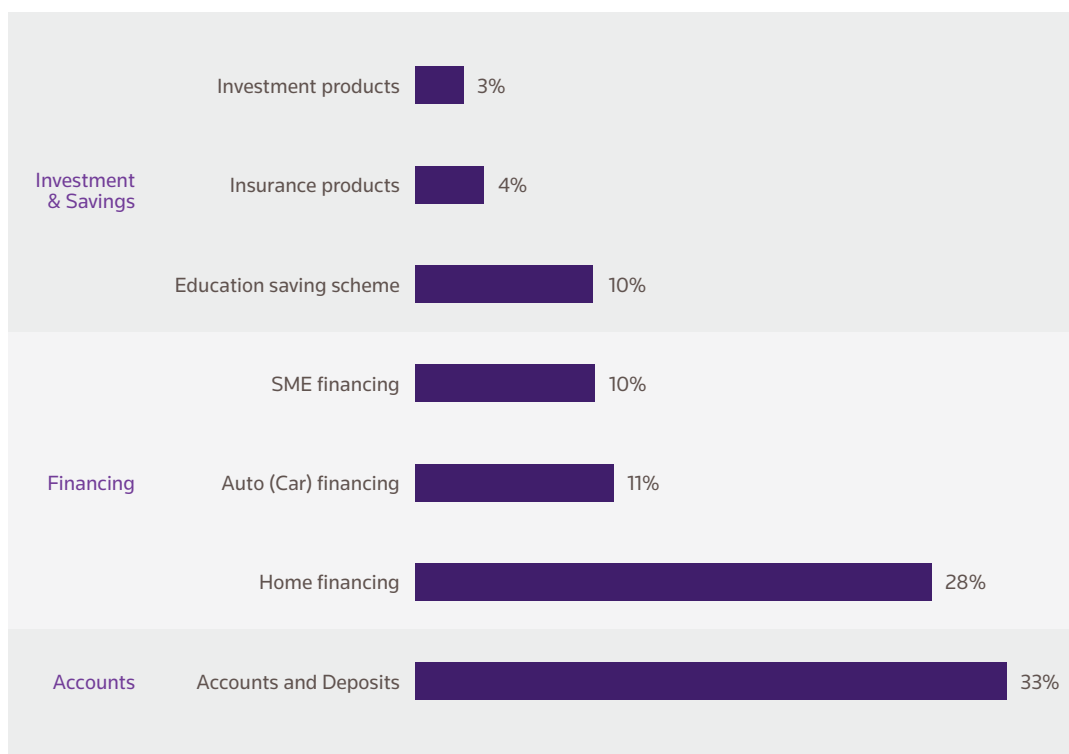
(Monday-Friday 9.00am-6.00pm)  
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Contact Person: Edige Alpysbay  
Email: [edige@amanieadvisors.com](mailto:edige@amanieadvisors.com)



## Products are the main determinant of banks' value proposition, and in Kazakhstan, financing products are in demand

### BANKING PRODUCTS AND SERVICES BASED ON CONSUMERS' NEEDS



Other than usual accounts and deposits that are in high demand by consumers in Kazakhstan — these accounted for 33% from the survey responses — financing products such as home financing, auto financing and SME financing are the next most in demand for consumers.

As mentioned earlier, one of the four main factors that should be part of a bank's strategic planning is product diversification. **Under the existing law, there is enough of a range of Shariah-compliant structures for Islamic banks to meet the demands of consumers. Accounts and deposits can be structured on wadiah, mudarabah and wakalah and commodity murabaha (tawarruq) can be used as the underlying structure for financing.**



# Leveraging Multi Banking Trends

YOUNG POPULATION

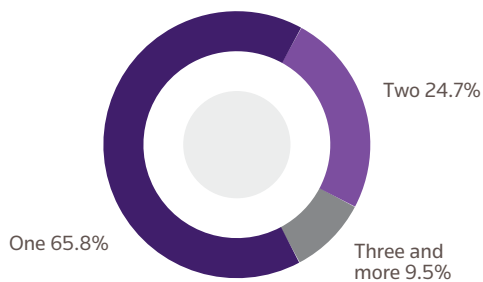
ARE MORE LIKELY

TO DEAL WITH

MULTIPLE BANKS

## Consumers who are not fully satisfied with their main banking services provider are likely to have more than one bank account

HOW MANY BANKS DO YOU CURRENTLY DEAL WITH?



Although the majority of respondents are loyal to their main banking services provider (65.8%); millennial consumers in the age group of 18 – 34 years are more likely to

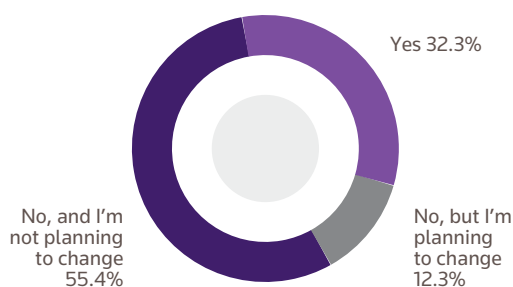
deal with two or more banking services providers (43%). Islamic banks should exploit any dissatisfaction towards current banking products and services, and promote the benefit of multi-banking especially within the millennial group (89%).

PERCENTAGE OF CONSUMERS WITH MULTIPLE BANKING RELATIONSHIPS (BY AGE GROUPS)



Currently young population are playing a huge role in socio-economic development, and in many developing countries, the working-age population constitute a bigger slice of healthier human resources and higher qualification. Banks therefore must adapt to the changing environment especially in such market dominated by young consumers who have the energy to intensify their search for products and services from multiple banks simultaneously with the use technology.

HAVE YOU EVER CHANGED YOUR MAIN BANKING SERVICE PROVIDER?





# Unlocking Latent Opportunities

HUGE POTENTIAL

FOR FAMILY TAKAFUL

IN KAZAKHSTAN



## Insurance sector a huge untapped market



The insurance sector in Kazakhstan is a small market with a very low penetration rate. Insurance assets to GDP ratio reached 1.58% in July 2015, highlighting a

**huge untapped market**, in which a potential demand for insurance products will increase on account of economic progress and projected growth in the level of per capita income.

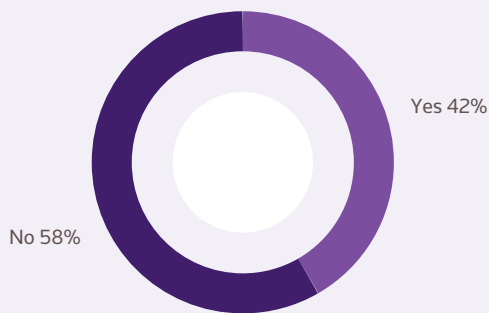
Insurance premiums have been on the rise since 2010, totalling USD 669.40 (KZT 124,588) million by June 2015 compared to USD 439.31 (KZT 64,723) million in June 2010.<sup>7</sup>

A majority of survey respondents do not have insurance (58%) but 16% of all who were sur-

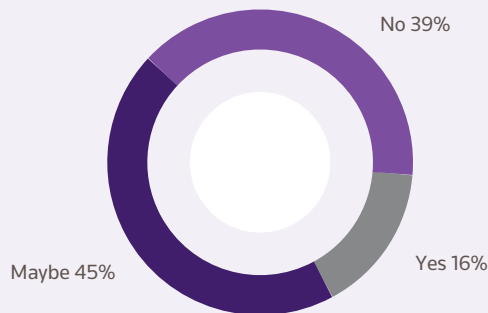
veyed said they would be interested in Islamic insurance if it were made available in the country, and 45% would 'maybe' be interested. There is, hence, only room for growth for takaful once it is offered in Kazakhstan.

There is significant market potential for Islamic insurance and there is a bundle of opportunities for takaful providers based on: very low insurance penetration rate overall, **low level of satisfaction with main insurance services providers**, and growth of the financial sector driven by the expansion of the middle class and a younger generation who are more financially-savvy and enjoying rising incomes.

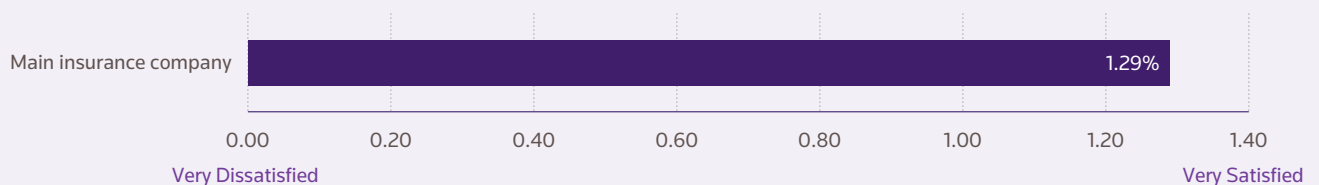
DO YOU DEAL WITH AN INSURANCE SERVICE PROVIDER?



WOULD YOU BE INTERESTED TO DEAL WITH AN ISLAMIC INSURANCE COMPANY IF THEIR PRODUCTS AND SERVICES BECOME AVAILABLE IN KAZAKHSTAN?



HOW SATISFIED ARE YOU WITH YOUR MAIN INSURANCE SERVICE PROVIDER?



### Takaful market opportunities lie in making takaful accessible and attractive for consumers, including:

1. Well-defined product distribution strategies such as bancatakaful or micro-takaful
2. Explicit brand strategies that will yield greater awareness and promote takaful as a brand
3. Focus plans to target consumers by promoting family takaful as it has the potential to grow rapidly in the coming years. This could happen as a result of increasing disposable

income that would balance out negative growth in other segments, i.e. negative development in property insurance following the currency fluctuation which will slow growth in general insurance/takaful. The currency devaluation will affect consumer appetite for general insurance other than the compulsory ones such as motor, third party and agriculture insurance.



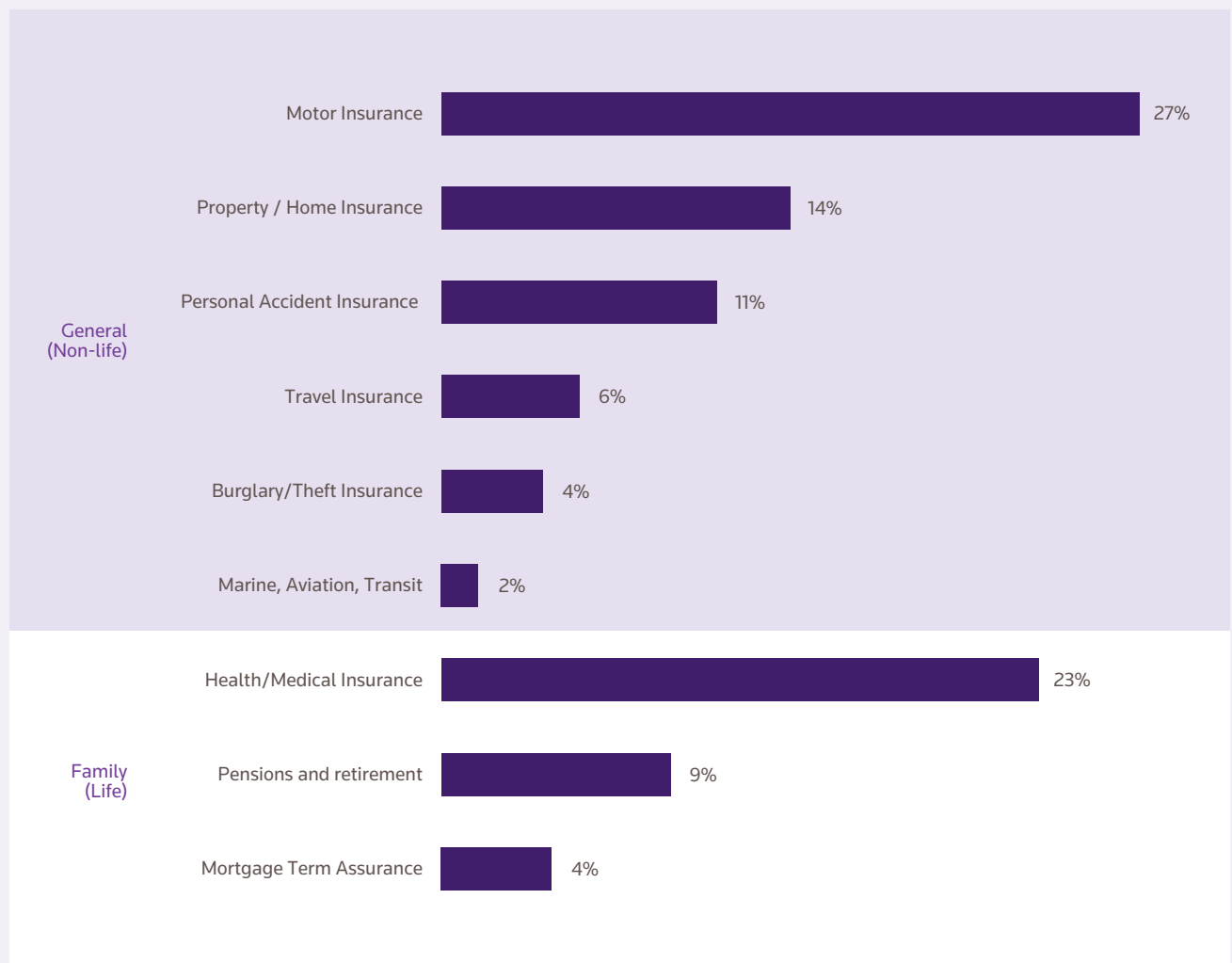
THE AVERAGE LIFE EXPECTANCY  
IN KAZAKHSTAN IS MOVING UPWARDS  
(WORLD BANK, WORLD DEVELOPMENT  
INDICATORS, 2013), WHICH,  
LEARNING FROM THE EXPERIENCE  
OF OTHER MARKETS, INDICATES A POSITIVE  
CORRELATION WITH THE DEMAND  
FOR LIFE INSURANCE.

## Health/ medical insurance most needed, and takaful companies should focus their efforts on offering such products

The average life expectancy in Kazakhstan is moving upwards (World Bank, World Development Indicators, 2013), which, learning from the experience of other markets, indicates a positive correlation with the demand for life insurance. This will be supported especially with the changing demographics: a larger population will seek more security as it grows older.

The survey results show that health/medical insurance is the second most needed product (23%) after motor insurance (27%) (which is compulsory) followed by pension and retirement (9%).

PLEASE CHOOSE THE FOLLOWING INSURANCE PRODUCTS AND SERVICES BASED ON YOUR NEEDS



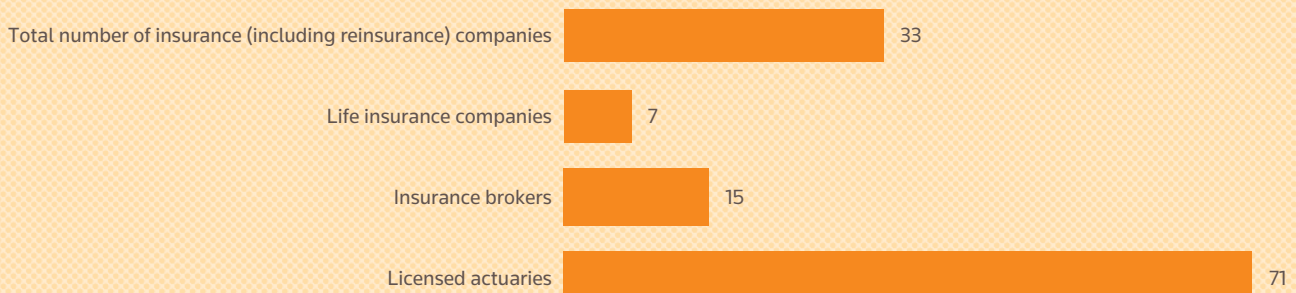


The Ministry of Finance of Kazakhstan, Astana, Kazakhstan.

# INSURANCE SECTOR IN KAZAKHSTAN

## Structure of insurance sector

### INSTITUTIONAL STRUCTURE



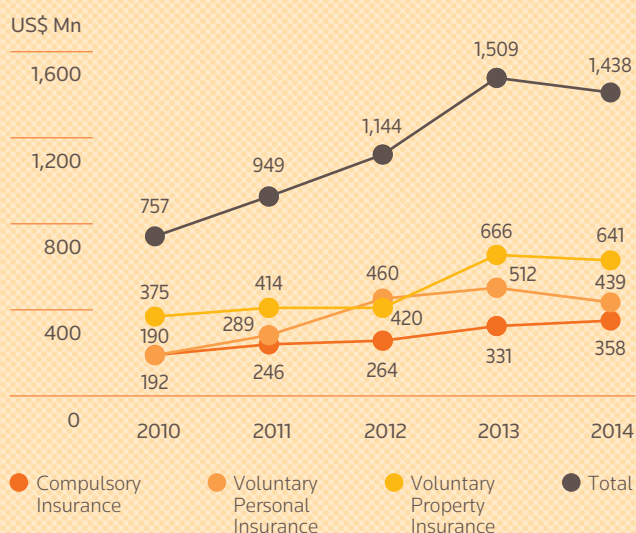
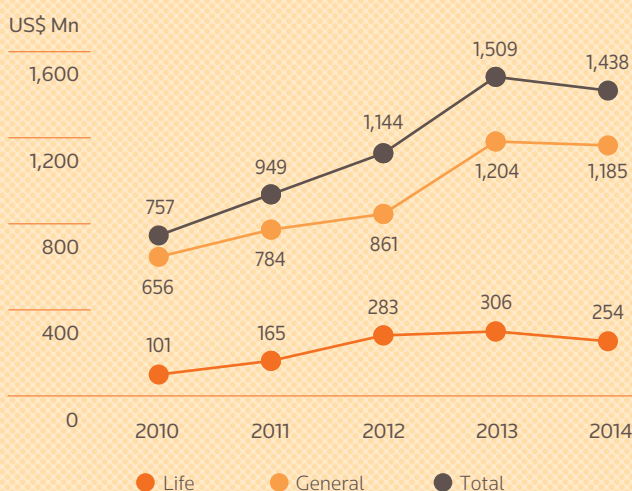


## Development of insurance sector

Insurance in Kazakhstan is a rapidly-developing market. Over the last five years assets of insurance companies

and the sum of collected insurance premiums increased twice. Average growth rates of the market was in excess of 15% a year.

## INSURANCE PREMIUMS (IN US\$ Mn)



## Development of Islamic insurance sector pre-2015 legislation: mutual insurance

In 2010 the Mutual Insurance Company was formed. In the absence of a law that would allow Islamic insurance mutual insurance was chosen as the closest to takaful. Founders of the company voluntarily took on the obligation to observe all Shariah requirements and to conform to international best standards.

In the lead-up to the establishment of MIC "Takaful" the organisation had to contend with several hurdles, including:

- Lack of opportunity to offer services of mandatory insurance (owing to legislative restrictions for mutual insurance companies);
- Lack of understanding of Islamic insurance system among customer base;
- Absence of a large investor.

Despite the difficulties it faced MIC "Takaful" has successfully brought to market a number of insurance

products, including medical insurance for pilgrims going to the hajj and umrah.

Today the team at MIC "Takaful" is a group of highly skilled professionals in the field of conventional and Islamic insurance, including skilled actuaries and the only Kazakh Shariah Adviser.

MIC "Takaful" also proved the case for viable Islamic insurance products and services and lobbied the acceptance in Kazakhstan of legislative changes to govern Islamic insurance. Over the last five years the company worked continuously with government bodies to develop the Islamic insurance system in Kazakhstan. Their efforts paid off when the law on Islamic insurance was passed in 2015.

According to the new legislation Islamic insurance companies in the form of joint stock companies are allowed and they can offer both general and life insurance. Takaful models allowed for use are mudarabah, wakalah or hybrid. Islamic insurance companies can carry out investment activities in Islamic securities worldwide, without being limited to the territory of Kazakhstan.

# Endnotes

- 1** Country Economic Work-December 2011, Islamic Development Bank.
- 2** Between 1992 and 1997, the Kazakhstan government liberalized most prices, imposed hard budget constraints on enterprises and banks, eliminated trade distortions and practically completed privatization of small- and medium-scale enterprises. Moreover, it has made substantial progress in reforming the banking and pension sectors, and has initiated programs aimed at augmenting the efficiency of financial and economic institutions.
- 3** No. 18 29 January 2015, [http://unctad.org/en/PublicationsLibrary/webdiaeia2015d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaeia2015d1_en.pdf)
- 4** National Bank of Kazakhstan
- 5** All year end data are based on January 1st of the next year.
- 6** National of Kazakhstan, Loan Market statistics by economy branches as of June 1, 2015.
- 7** Current state of the insurance sector of the Republic of Kazakhstan as of June 2010 and 2015 Statistics – National Bank of Kazakhstan.



# Қазақстан қаржыгерлерінің қауымдастығы

## Ассоциация финансистов Казахстана

### Financial Institutions' Association of Kazakhstan

Established in 1999.

Large representation and membership: 167 organizations including banks, insurance companies, brokers, leasing companies, microfinance companies, auditors, consulting companies, education organizations and other professional associations.

#### MISSION

To promote development of financial markets, and to improve the legislation and the regulation of financial organizations of the Republic of Kazakhstan .


#### MAIN OBJECTIVES

- Representation of Members' interests in state and other bodies;
- Improvement of laws and regulations of the Republic of Kazakhstan;
- Cooperation with governmental authorities on developing financial system in the Republic of Kazakhstan.


#### ACTIVITIES


- Participation in preparing the laws and the regulations of the Republic of Kazakhstan related to financial markets and taxation;
- Review and collation of Members' proposals on improving the relevant legislation;
- Involvement in implementation of financial, fiscal, budgetary, tax and foreign exchange policies in Kazakhstan;
- Contribution in advancing the financial markets' infrastructure;
- Assistance in preparing the measures and actions on support and advocacy of domestic entrepreneurs;
- Informational assistance to Members.

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# Acknowledgment



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The goals and motivations of this report follow in the same vein as the previous country reports – to serve the needs of the Islamic finance industry and to provide financial institutions, governmental bodies & associations, customers and other stakeholders with high quality intelligence and insights into the Islamic finance opportunity in Kazakhstan in order to help all parties make informed decisions. This report reflects the efforts of a broad and diverse group of experts.

The authors extend their appreciation to National Bank of Kazakhstan (NBK) for their extensive support during the preparation of the report.

We would like also to express our appreciation to Thomson Reuters' management, particularly Nadim Najjar (Interim Managing Director, GGO Middle East, Africa and Russia) for his trust in and commitment to our work.

Sincerely,

IFCR Team

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4		Alfiya Salikhova	Head of Research Committee
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28		Dr. Leonid GUREVICH	President of BISAM
29	BISAM	Aigul KABINOVA	Head of Research Dept
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32		AsselZhapisheva	Treasury Department
33		Bauyrzhan SIYABEKOV	Investment & Relationship Manager
34	New Finance	Timur Alim	Chief Executive Officer
35		Berilk MUSSABEKOV	
36	KIC Leasing	Yusuf Karsi	Chief Executive Officer
37	Zaman Bank	Diar N. SMAGULOV	Deputy Chairman of BoD
38	DBK Leasing	Kanat ABZALOV	Head of Project Manager
39		Ruslan BEKETAYEV	Vice Minister
40	Ministry of Finance	Ruslan Meirkhanov	Director of State borrowing department
41	Ministry for investments and development	Yerlan Baidaulet	Adviser to the Minister of investments and development











It is a first organization in Kazakhstan and CIS countries which provides Islamic insurance services from 2010 in fully consistent with all rules and principles of Shariah.



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