

**Republic of Kazakhstan—Financial Sector Assessment Program Update—
Detailed Assessments and Updates of Financial Sector Standards and Codes**

This Detailed Assessment and Updates of Financial Sector Standards and Codes for the **Republic of Kazakhstan** was prepared by a joint staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in **August 2004**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the **Republic of Kazakhstan** or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

REPUBLIC OF KAZAKHSTAN

DETAILED ASSESSMENTS AND
UPDATES OF FINANCIAL
SECTOR STANDARDS AND
CODES

AUGUST 2004

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GLOSSARY AND ABBREVIATIONS

AAMC	Association of Asset Management Companies
ACH	Automated Clearing House
AECC	The Agency for the Fight Against Economic and Corruption Crimes
AFK	Association of Financiers in Kazakhstan
AMC	Asset Management Company
AML	Anti-Money Laundering
BIS	Bank for International Settlement
CFT	Combating the Financing of Terrorism
CP	Core Principle
CSD	Central Securities Depository
DVP	Delivery-versus-Payment
EU	European Union
FATF	OECD's Financial Action Task Force on AML and CFT
FIU	Financial Intelligence Unit
FMRA	Financial Market and Financial Organizations Government Regulation and Supervision Act
FSA	Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Financial Organizations
FSAP	Financial Sector Assessment Program
FT	Financing of Terrorism
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
ICSFT	International Convention of the Suppression of Financing of Terrorism
IFRS	International Financial Reporting Standards, formerly IAS
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
ISMT	Interbank System of Money Transfer
IT	Information Technology
KASE	Kazakhstan Stock Exchange
KISC	Kazakhstan Interbank Settlement Center
KNB	Kazakhstan's National Security Committee
KRKCA	Kazakhstan Registrars' Association
T	Tenge, local currency unit. At end-2003, US\$1 = T 144
LVTS	Large-Value Transfer System
ML	Money Laundering
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MOJ	Ministry of Justice
NBK	National Bank of Kazakhstan
NSC	National Securities Commission
OECD	Organization for Economic Cooperation and Development
OTC	Over-the-counter
PO	Prosecutor's Office
ROSC	Report on Observance of Standards and Codes
SRP	Retail payment system

RTGS	Real-time gross settlement
SCR	Security Council Resolutions
SDDS	Special Data Dissemination Standard
SLP	Large-value interbank payment system
SME	Small and Medium-sized Enterprises
SML	Securities Market Law
SPF	State Pension Fund
SRO	Self Regulatory Organization
STR	Suspicious Transaction Reporting
SWAP	Combined spot and forward transaction
TF	Terrorist Financing
UN	United Nations
UNSCR	United Nations Security Council Resolutions
WB	World Bank

I. COMPLIANCE WITH THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

1. This assessment of the current state of Kazakhstan's implementation of the Basel Core Principles for Effective Banking Supervision has been completed as part of a Financial Sector Assessment Program update undertaken jointly by the World Bank and International Monetary Fund in February 2004. An assessment of the effectiveness of banking supervision requires a review of the legal framework, both generally and as specifically related to the financial sector, and a detailed examination of the policies and practices of the institutions responsible for banking supervision.

2. This assessment occurs after very significant changes have been implemented in the legal foundation for supervision and its practical implementation. In addition to many legal reforms to address issues identified in the 2000 assessment of implementation of the Core Principles undertaken as part of the original Kazakhstan FSAP, and in response to evolving international best practice, effective January 1, 2004, responsibility for all financial sector supervision was vested in a new authority, the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Financial Organizations (FSA).

Information and methodology used for the assessment

3. The assessment team reviewed the legal framework for banking supervision, held extensive discussions with the staff of the National Bank of Kazakhstan (NBK), FSA, and participants in the banking and financial markets.¹ The assessment team enjoyed excellent cooperation with its counterparts, and received all the information it required, and extends its thanks to the Chairman and staff of the FSA, the staff of the NBK, and various members of the private sector who met with the assessment team.

4. Reaching conclusions required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are changing rapidly around the world, and theories, policies, and best practices for supervision are swiftly evolving. Nevertheless, by adhering to a common, agreed-upon methodology, the assessment should provide the Kazakhstani authorities with a reliable measure of the quality of its banking supervision in relation to the Core Principles, which are internationally acknowledged as minimum standards.

5. The assessment of compliance with each principle is made on a qualitative basis. A four-part assessment system is used: compliant; largely compliant; materially non-compliant; and non-compliant. To achieve a "compliant" assessment with a principle, all essential criteria generally must be met without any significant deficiencies. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that

¹ The assessment was conducted by Michael Andrews (World Bank consultant) and Tonny Lybek (MFD, IMF).

principle. A “materially non-compliant” assessment is given when the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance, but substantive progress had been made. A “non-compliant” assessment is given when no substantive progress toward compliance has been achieved.

6. The assessment team has explicitly noted the changes that have taken place since the original 2000 assessment of implementation of the Basel Core Principles. The comments section of each principle notes the progress in meeting the essential criteria since 2000, as well as any further measures required to reach full compliance. In many cases, the very recent amendments to the legal framework and establishment of the new supervisory agency mean that at the time of the assessment, there was an absence of evidence of effective implementation.

General preconditions for effective banking supervision

7. The banking sector in Kazakhstan has benefited from a period of strong economic growth, which has increased demand for credit. The domestic banking system has grown rapidly in size, while the number of banks has continued to decline. Despite the successful introduction of deposit insurance, the growth of household deposits has lagged the growth of the banking sector overall, with the result that much of the banking sector is dependent on wholesale funding. There is significant dollarization, and the largest banks use syndicated loans, Eurobonds, or medium-term note issues as a major part of their funding.

8. While the banking system overall is liquid, there are significant variations from bank to bank, with the distinctions between the tenge and foreign exchange liquidity being quite important. The smaller banks frequently have difficulty attracting deposits, do not have access to international markets, and generally are not afforded unsecured limits by the larger banks in the interbank market. Halyk Savings bank, by virtue of its large branch network and retail focus, tends to be a net provider of tenge liquidity in the interbank market, while Kazkommerts Bank, with the longest history of access to international markets, has been a net provider of foreign currency liquidity.

9. An appropriate body of commercial law is in place, and both banks and the supervisory authority express general satisfaction with the functioning of the systems for registration of collateral and enforcement of security interests. The judiciary is said to be developing greater familiarity with commercial and banking matters, making decisions more predictable, and in the view of some market participants, more likely to be based on appropriate interpretations of the law.

10. Government infrastructure is well established, although some market participants express concern that the legal power of customs and tax authorities to obtain information from the commercial banks may be used for “fishing expeditions” or to harass legitimate

businesses. The distortionary effects of some aspects of the tax system are also of concern.² Banks are restricted in the amount of interest paid that can be deducted from income for tax purposes, which has the perverse effect of driving up loan interest rates so that banks can continue to earn an equivalent after-tax return for shareholders. The tax-exempt status of interest earned on bank deposits may discourage investment in other instruments.

11. Kazakhstani banks have been required to use International Financial Reporting Standards (IFRS—previously International Accounting Standards—IAS) since January 1, 2003. The previously applicable Kazakhstan Accounting Standards were based on IAS, with some important differences. Implementation of accounting standards has improved. However, it appears that the smaller banks have not matched the progress of the larger banks in the introduction of internal systems that truly reflect IFRS or the pre-existing Kazakhstani standards. While these banks do meet the legal requirement to report to the supervisory agency in an IFRS format, this may be achieved through the use of “transformation matrices,” rather than the use of systems that actually support IFRS.

12. The deposit insurance regime was significantly revised in 2003, with participation made mandatory for all banks licensed to accept deposits effective from January 1, 2004. The previous overly complex coverage limit, which provided different percentages of insurance through five different gradations of deposit size, has been replaced with a single limit of T 400,000. There is no practical experience with the deposit insurance fund, as only one of the four banks that failed since its inception in 1999 was a member of the fund, and in this case, the NBK made extraordinary ex gratia payments to compensate most depositors. The Deposit Insurance Fund does not have supervisory powers.

13. The introduction by the deposit insurance fund in 2003 of interest rate ceilings on deposits is a cause for concern. Payment of excessive deposit rates by some banks is likely an indicator of increasing risk of loss on the part of the deposit insurance fund, but timely supervisory action is the more appropriate response. The current “paybox” model of deposit insurance does not provide supervisory authority to the deposit insurance fund. While the structure in some countries provides the deposit insurance agency with its own supervisory capacity, this is not necessary provided that the supervisory agency acts in a timely manner, either in response to its own identification of warning signs such as excessive interest rates, or in response to a request from the deposit insurance agency. The assessment team strongly recommends removal of the limits on deposit interest rates, with on-site examinations and remedial measures, including if necessary license revocation, to deal with weak banks.

14. The legal framework for dealing with problem banks has been significantly revised to give the supervisory authority more control over the liquidation process. The banking law provides the supervisory authority a wide range of remedial measures, including the ability to revoke licenses. Previously, bank liquidation was overseen by the courts, and in many cases this resulted in a very slow process, often involving the use of liquidators with little

² Reportedly, some of the tax rules were introduced to minimize aggressive foreign borrowing without adequate capital, thus promoting financial sector stability.

understanding of banking. Under the new process, while the courts are still responsible for issuing liquidation orders, the supervisory agency will be able to appoint a temporary administrator, likely one of its employees, to secure the assets of the bank until a liquidation order is issued. When a liquidation order is issued, the supervisory agency selects the chair of the liquidation committee, who will generally be an employee of the FSA or of the deposit insurance fund. While there is no experience with the new system, it appears that these recent changes have addressed key weaknesses previously noted in the legal framework for bank liquidations.

Principle-by-principle assessment

15. This assessment has been completed only against the essential criteria. The description and comments touch on the additional criteria when viewed appropriate by the assessment team. However, the level of implementation of the additional criteria has not affected the overall assessment of each core principle.

Table 1. Detailed Assessment of Basle Core Principles

Principle 1.	<p>Objectives, autonomy, powers, and resources</p> <p>An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>
Principle 1(1).	<p>An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.</p>
Description	<p>Law 474-II on Government Regulation and Supervision of the Financial Market and Financial Organizations establishes the objectives of ensuring stability of financial markets and financial organizations, maintaining confidence, protecting consumers and ensuring fair competition in the markets (Article 3). This law, enacted in July 2003 and effective as of January 1, 2004, provides for the establishment of a new financial supervisory agency (FSA). The objectives of financial supervision are reaffirmed and expanded in Chapter 2 of Presidential Decree 1270, enacted December 2003. Decree 1270 designates the FSA for the Regulation and Supervision of the Financial Markets and Institutions as the authorized agency contemplated in law 474-II and provides detail on the establishment of the FSA, including its structure and powers, and the provisions for transfer of staff and property from the NBK to the new agency.</p> <p>Article 61 of the Law on the National Bank of Kazakhstan sets the NBK’s objectives relative to supervision of the banking system as “maintaining the stability of the monetary system of the Republic of Kazakhstan, and protecting the interests of banks’ creditors, depositors, and customers.” While much of the supervisory authority previously vested in the NBK has been passed to the new agency, the NBK retains broad responsibility for financial stability, and also supervisory and licensing powers in specifically enumerated areas related to banking. These include foreign exchange activities and payment systems. The NBK and the FSA are jointly charged with some responsibilities, such as the establishment of accounting standards (Article 7 of Decree 1270).</p>

	<p>The Law on Banks and Banking as amended provides the “authorized agency” with a range of supervisory powers, some of which are explicitly shared with the NBK (for example licensing, Article 26). Article 41 specifically requires the authorized agency to regulate the activity of banks, including establishing prudential standards, giving binding legal instructions to banks, applying enforcement procedures and sanctions. Article 54 provides a broad power to require banks to furnish information, including on a consolidated basis, for supervisory purposes. Article 54.1 gives a legal foundation to obtain information from affiliates of a bank. Decree 1270 further enumerates the areas in which the FSA has regulation-making authority (Chapter 2), including a broad provision to establish prudential requirements and other norms (Chapter 2, Article 10). The supervisory agency is also provided with a broad authority to obtain information necessary for supervisory purposes from banks and their affiliates (Chapter 2, Article 14).</p>
<p>Assessment</p>	<p>Largely compliant.</p>
<p>Comments</p>	<p>This principle was assessed as materially-non compliant in 2000, largely due to significant shortcomings in the legal framework for banking supervision. Chief among these was the failure of the courts to uphold important supervisory decisions, including two instances where revoked licenses had been reinstated by court order. Following significant revisions to the legal framework for supervision, an evolution in the judiciary that has resulted in supervisory decisions being upheld when challenged, and the creation of the new supervisory agency, some additional progress is still required. An agreement between the NBK and the FSA was signed the last day of the mission, but should be effectively implemented (essential criteria 3). However, when revised, consideration should be given to also clarify the broader overlapping responsibilities regarding financial sector stability with a view to ensure that the central bank and supervisory agency coordinate effectively. While the requirement to update the legal framework as necessary has been met (essential criteria 5), the assessment team is concerned that the very frequent amendments to the banking law and issuance of new resolutions may make it difficult for market participants to comply with rapidly changing requirements. The supervisory agency might consider implementing revisions to laws and resolutions, and introduction of new resolutions once or twice each year, after a period of full consultation with the industry.</p>
<p>Principle 1(2). Each such agency should possess operational independence and adequate resources.</p>	
<p>Description</p>	<p>Law 464-II establishes that the “authorized body shall be directly subordinated and answerable to the President of the Republic of Kazakhstan” and will be financed by budget funds of the NBK (Article 7). Decree 1270 confirms that the funding of the FSA will be provided from the budget of the central bank. Agency staff anticipate moving to a self-funding basis by 2007, but at present there is no legal provision for the FSA to establish its own funding base, for example through the levying of fees on supervised entities.</p> <p>The structure and total authorized personnel of the FSA are subject to approval by the President (Article 7, Decree 1270). The authorized complement of individuals for the FSA has been established as 300 persons. The president is empowered to appoint and dismiss the FSA chairman (Article 19, Decree 1270) and deputy chairman (Article 21). No fixed term is specified for the chairman or deputy chairman, nor are conditions for removal. Article 26 of the law on Public Service does stipulate that misdeeds are ground for dismissal, but it does not protect the members from arbitrary dismissal. The FSA is required to submit an annual report to the president, and financial statements and other information to the NBK (Article 29).</p> <p>The head of the Banking Supervision Department is appointed by the FSA Chairman. The Decree on Civil Servants specifies minimum educational and work experience requirements for the head of the departments and divisions within the department. While salary scales are somewhat lower in the FSA and the NBK than at commercial banks, recent increases have brought scales closer to the private sector.</p> <p>The budget is currently viewed as adequate for supervisory activity, although there are some</p>

	<p>uncertainties arising from the very recent creation of the FSA. Planning, budgeting, and expenditure procedures are still under development, and there are a number of as yet unfilled positions within the total authorized complement of 300.</p> <p>The NBK law (Articles 13 and 14) provides that the governor and deputy governors of the NBK serve a six-year term. The governor is appointed by the president with the approval of parliament, and may be removed by the president for any reason (Article 13). Deputy governors are appointed by the president on the recommendation of the governor (Article 14) and may be removed by the president on recommendation by the governor (Decree 1271, Article 29).</p>
Assessment	Materially non-compliant
Comments	<p>This principle was assessed as materially non-compliant in 2000. Progress has been made in increasing the salary levels within the supervisory agency so that they are closer, although still below, those paid by commercial banks. However, there are significant numbers of vacancies in every division involved in banking supervision. Management of the various departments and divisions are concerned about the ability to attract suitably trained and experienced staff to fill current vacancies (essential criteria 3). It is not yet clear whether the authorized complement of 300 staff for the agency is appropriate. As an initial step, existing vacancies should be filled and an analysis undertaken as to whether this provides sufficient staff resources to implement fully adequate on-site and off-site supervision, including the new approach to financial conglomerates. The FSA's budgetary autonomy must be ensured.</p> <p>The new supervisory agency may have less operational independence than the NBK. While the chairman and deputy chairman of the NBK are appointed for fixed terms, the chairman and deputy chairman of the FSA do not have fixed terms, and may be removed by the president for any reason. The staff complement of the FSA is established by the president, and budget funds and premises are provided by the NBK. The law establishing the FSA should be revised to (1) provide fixed terms for the senior management (additional criteria 1) and (2) that should a chairman be removed, the reasons must be publicly disclosed (additional criteria 2).</p>
Principle 1(3).	A suitable legal framework for banking supervision is also necessary, including provisions relating to the authorization of banking establishments and their ongoing supervision.
Description	<p>The law on banks and banking and a range of NBK resolutions addressing prudential standards and reporting requirements constitute the main components of the legal framework for banking supervision. Regulations issued previously by the NBK remain in force, and the FSA is empowered to issue regulations. Article 13 of the law on Banks and Banking provides that the authorized agency is empowered to issue permits to open banks and deal with licensing. Article 26 of the banking law provides that licenses shall be issued by either the authorized agency or the NBK. Article 42 provides that the authorized agency is empowered to set prudential standards administratively, citing both specific subjects such as minimum capital requirements, and providing a broader authority to establish binding norms for prudential standards used in international banking practices. The NBK Law also provides a broad regulation making power. Decree 1270 further confirms this regulation making authority, both with respect to specific matters such as capital adequacy and licensing, but also more broadly for prudential requirements and norms.</p>
Assessment	Compliant
Comments	<p>This principle was assessed as compliant in 2000. One concern previously noted continues to be relevant. The NBK perhaps made too liberal use of its regulation-making power. The FSA should consider adopting a philosophy of regulation that is based less on providing very explicit directions to banks and more on requiring banks to have appropriate policies to enable them to conform to the prudential requirements. This approach, which is reflected to some extent in the new risk management requirements introduced by resolution 434 in December 2003, might reduce the need for almost continual amendments to resolutions and bank reporting requirements.</p>

Principle 1(4). A suitable legal framework for banking supervision is also necessary, including ... powers to address compliance with laws as well as safety and soundness concerns.	
Description	Articles 46-48 of the banking law provide for a range of enforcement measures and sanctions, including license revocation. Article 47.1 provides a legal basis to require holding companies and bank affiliates to take remedial actions. Both the banking law and Decree 1270 provide a broad power for the FSA to obtain any information from banks and their affiliates necessary for supervisory purposes.
Assessment	Largely compliant.
Comments	This principle was assessed as materially non-compliant in 2002. The most serious defects have been addressed through amendments to the banking law with respect to liquidation, and the absence since 2000 of court decisions overturning supervisory actions. A further enhancement required to reach full compliance is an explicit provision in law that the supervisor may exercise qualitative judgment (essential criteria 2). The legal framework is very rules-based, and in some instances, such as determining the fitness and probity of significant shareholders and senior management, the supervisory authority should explicitly have the discretion to determine someone unfit even if not convicted of a serious crime.
Principle 1(5). A suitable legal framework for banking supervision is also necessary, including... legal protection for supervisors.	
Description	Article 922 of the Civil Code provides that the state treasury will pay the costs of any court judgment arising from action or non-action by an official in connection with public administration.
Assessment	Compliant.
Comments	This principle was assessed as compliant in 2000.
Principle 1(6). Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.	
Description	<p>The establishment of a single financial supervisory authority should ensure domestic coordination and information sharing with respect to the oversight of banking, insurance and the capital markets. There are a number of areas of shared responsibility with the NBK, and more broadly the NBK's responsibility for financial sector stability will require ongoing coordination and cooperation. At the last day of the mission, a formal agreement on working relationships between the FSA and the NBK was signed.</p> <p>A number of MOUs (memoranda of understanding) have been signed with foreign supervisors, including Turkey, Pakistan Egypt, Moldova, Bahrain, Azerbaijan, Belarus, Georgia, and Tajikistan. In practice, there is limited contact and information exchange with foreign supervisory authorities.</p> <p>The provisions of bank secrecy (Article 50 of the Law on Banks and Banking) provide that information can be released with the approval of a prosecutor (not a court or judge) for investigative and preliminary inquiries and to tax and customs authorities.</p> <p>Article 14 of Law 474-II provides that the supervisory agency can share information that would otherwise be confidential under the banking secrecy provisions of Article 50 of the law on banks and banking. Confidential information can be shared with foreign supervisory authorities and law enforcement agencies within and outside Kazakhstan, when this is required for legitimate purposes.</p>
Assessment	Largely compliant.
Comments	This principle was assessed as materially non-compliant in 2000, largely because the NBK was not in receipt of timely information about the capital market activities of subsidiaries and affiliates of banks, which at that time were supervised by a separate agency. Consolidation of all financial market supervision in a single agency should address this concern, although, as noted in Core Principle [CP] 1(1), there is a need for a formal agreement including provisions for information sharing between the NBK and the new agency (essential criteria 1). The

	assessment team is also concerned about the balance between keeping bank customer information confidential, and the legitimate requirements of tax and other authorities. The ability provided in law (Article 50 of the law on banks and banking) for prosecutors, and the tax and customs authorities to obtain information from banks without a court order could be misused for “fishing expeditions” or to harass legitimate customers.
Principle 2.	Permissible activities The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word “bank” in names should be controlled as far as possible.
Description	A bank is defined in article 1 of the Decree on Banks and Banking as a legal entity and a commercial organization authorized in accordance with the provisions of the decree to engage in banking. Article 6 prohibits the undertaking of banking activities or the use of “bank” in the name of an entity unless it has an appropriate license from the NBK and/or the authorized agency. Article 30 provides further description and definition of banking.
Assessment	Compliant
Comments	This principle was assessed as compliant in 2000.
Principle 3.	Licensing criteria The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization’s ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
Description	<p>Article 62 of the NBK law states that the NBK will be responsible for licensing and empowers it to set licensing requirements. Article 13 of the law on Banks and Banking provides that the “authorized agency” is empowered to issue permits to open banks and deal with licensing. Article 26 of the banking law provides that licenses shall be issued by either the authorized agency or the NBK. In practice, it is expected that the authorized agency would issue licenses, having first obtained an opinion from the NBK with respect to its specific areas of responsibility such as foreign exchange and payment systems.</p> <p>The law contemplates a two-stage process, where a permit to open a bank would be granted first, followed by granting of a license when all things required by the permit have been completed to the satisfaction of the licensing authority. The authorized agency is required to consider an application for a permit to open a bank within six months of receipt of the application (Article 23). Specific issues to be considered in the application include a viable business plan with appropriate management structure, internal controls and risk management (Article 24).</p> <p>Some further detail on procedures for application of a permit to open a bank and banking license together with the required forms are provided in Resolution No. 50, May 9, 1999, as amended.</p> <p>The file for the only new license recently granted (Zhilstroi bank, 2003) was reviewed as part of the Core Principles assessment. Documentation was complete in accordance with the requirements of the resolution, and included evidence of the vetting of the directors and senior staff, and review of the banks’ proposed business plan and systems for internal control. While there is scope to increase the depth of analysis, the license review process appears to have been of a generally high standard.</p> <p>All banks are subject to a minimum capital requirement of T 2 billion (Resolution 190). Fifty percent of the capital must be paid at registration, and 50 percent within one year (Law on Banks and Banking Article 16).</p>

	<p>In the case of subsidiaries of foreign banks, the home regulator must confirm that the foreign bank has a valid banking license and is subject to consolidated supervision (Resolution 50, Article 23), and consent (or nonobjection) to the application.</p> <p>Decisions of the NBK to deny a license may be appealed to the courts (Resolution 50, Article 94).</p>
Assessment	Largely compliant.
Comments	<p>This principle was assessed as largely compliant in 2000. There have been no fundamental changes in the licensing regime since then, aside for the transference of most licensing authority from the NBK to the FSA. As in 2000, the assessment team believes that it would be better to have a provision in law expressly establishing the ability of the FSA to exercise judgment is assessing the adequacy of the various parts of the application (essential criteria 3), as well as express consideration of whether the proposed legal and managerial structure would hinder effective supervision (essential criteria 3). It is also important the procedures for coordination on licensing included in agreement between the FSA and the NBK be implemented. Consideration might be given to include some general provisions regarding fit and proper requirements in the banking law, for instance regarding shareholders having a record regarding serious economic crimes.</p>
Principle 4.	<p>Ownership Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.</p>
Description	<p>Article 17.1 of the Law on Banks and Banking prohibits control of 10 percent of more of a bank (a “principal partner”) without the consent of the authorized agency. Owners of 25 percent or more of a bank are deemed a holding company. Persons (including legal persons) seeking control of more than 10 percent of a bank must provide a range of information to the supervisory authority to facilitate review of their financial capacity and fitness and probity to have a significant shareholding in a bank. Article 47.1 provides that sanctions may be taken against affiliates of banks, including requiring principal partners and holding companies to divest or dilute their shareholdings.</p> <p>The authorized agency conducts reviews of principle shareholders and holding companies. The documents required are intended to attest to the financial capacity of the shareholders. Judicial persons registered in an offshore zone included in a proscribed list maintained by the supervisory agency, or a natural person affiliated with such judicial persons, may not obtain a significant ownership stake in a bank.</p>
Assessment	Largely compliant.
Comments	<p>The principle was assessed as materially non-compliant in 2000, largely because of numerous instances where transfers of significant ownership stakes in bank had taken place without the consent of the NBK, and upon discovery, frequently without any ensuing supervisory action. Revisions of the banking law to require affiliates of banks to provide information required by the supervisory authority (Article 17.1) have permitted the identification of the beneficial ownership of almost all significant shareholdings in Kazakhstani banks. Essential criteria 3 has not been fully met because there is still one importance instance of shares held in nominee form by the Bank of New York, where beneficial ownership has not been traced. The FSA is unable to determine who the ultimate owners are of these shares, and whether changes in ownership may take place without the knowledge and approval of the supervisory authority.</p> <p>In addition, the review process should be further strengthened by the introduction of broader fit and proper criteria and more thorough verification of the documents provided by prospective shareholders. The declarations and financial documents submitted by shareholders are not verified by the authorized agency, so it would be possible for shareholders to make false declarations. Fit and proper criteria should be expanded to exclude persons previously associated with unsavory business activities, or legal persons whose beneficial ownership cannot be determined.</p>

<p>Principle 5. Investment criteria Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.</p>	
Description	<p>Article 8 of the Law on Banks and Banking prohibits banks from undertaking commercial activities, and provides a limited list of types of entities in which banks may hold equity. Generally, the law provides that banks may not undertake in subsidiaries activities that would be proscribed for the bank itself, with exceptions for businesses closely related to banking, and the temporary holding of commercial assets and the equity of commercial firms acquired pursuant to security agreements. Banks may hold portfolio investments in the shares of listed companies (not exceeding 10 percent of bank capital, and 15 percent of the listed shares). Banks are permitted to hold controlling interests in other commercial banks and investment banks. The Law on Banks and Banking provides that investments in subsidiaries will be deducted from capital for regulatory purposes, and NBK Resolution 427 provides that the supervisory authority must be notified in advance of the intent to establish or acquire a permitted subsidiary. The resolution empowers the supervisory authority to prohibit such a transaction if it would result in a significant deterioration of the financial position of the bank.</p>
Assessment	Largely compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000, largely due to the absence of a provision to prohibit a transaction if the acquisition or investment would hinder effective supervision (essential criteria 3). This concern has been mitigated by the introduction of Article 17.1 of the banking law, which provides a legal basis for the supervisory agency to require affiliates and subsidiaries of banks to provide any information required for supervisory purposes. Nevertheless, it would be better for Article 8 of the banking law to be amended to expressly permit the supervisory authority to prevent the establishment or acquisition of a subsidiary that might impair effective supervision. For example, the supervisor should be able to prohibit the creation of a subsidiary to provide data processing or management services to a bank, unless it is fully satisfied prior to the establishment of the subsidiary that all information necessary for supervision will be available on a timely basis.</p>
<p>Principle 6. Capital adequacy Banking supervisors must set minimum capital requirements for banks that reflect the risks the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.</p>	
Description	<p>NBK Resolution 213, June 2002, requires all banks to have minimum tier I capital equivalent to six percent of risk-weighted assets, and total capital (tier I and tier II) 12 percent.</p> <p>The eligible components of capital as specified in the resolution are generally consistent with the Basel Capital Accord. Tier I capital may include initial paid-in capital, additional equity issues, retained earnings (or losses), and unallocated general provisions, less intangible assets and current year losses. Tier II capital, which cannot exceed the amount of tier I capital, may include current year profits, revaluation of fixed assets and securities, general reserves (which may not exceed 1.25 percent of risk-weighted assets), and subordinated debt (which may not exceed 50 percent of tier I capital). Investments in subsidiaries are to be deducted from tier I capital (Article 3). Off-balance sheet risks are specifically referenced in attachment II to the resolution.</p> <p>The resolution makes extensive use of corporate, sovereign and sub-national government ratings in determining the weightings of various exposures to government. Thus, in place of the Basel Capital Accord recommendation that claims on OECD (Organization for Economic Cooperation and Development) central governments and banks attract a zero-risk weighting, the Kazakhstani standard is that loans to central governments or central banks having a Standard and Poors or equivalent rating of AA or above may be zero risk-weighted. Exposure to multilateral institutions, provided they have a rating of AA or above, may be zero risk-</p>

	<p>weighted, versus the 20 percent recommendation of the Basel Capital Accord.</p> <p>The resolution provides that corporate exposure can attract less than a 100 percent risk-weighting provided it has a rating above BBB+. Corporations with a rating between A+ and A- are risk-weighted at 50 percent, while ratings not below AA- can be weighted at 20 percent. Exposure to all unrated corporations is weighted at 100 percent.</p> <p>The Kazakhstani approach to risk weights provided a more nuanced approach to capital adequacy, but is unlikely to result in significantly lower capital adequacy than would be required using the Capital Accord weightings due to the prevalence of unrated corporations in the asset portfolios of Kazakhstani banks. Given the capital adequacy requirement of 12 percent, a bank would only have a lower capital base than that required using the Basel 8 percent minimum and Basel risk weightings if it had a very significant exposure to highly rated multilateral institutions and corporations.</p> <p>Resolution 250, July 2003 introduced capital adequacy requirements on a consolidated group basis. No evidence was provided to the assessment team of the verification and enforcement of this requirement. The FSA is still putting in place its approach to conglomerate supervision.</p> <p>Article 42 of the Law on Banks and Banking requires a bank in violation of capital adequacy requirements to present a recovery plan to the supervisory authority within one month. Articles 46 to 48 provide the authorized agency with the ability to impose a range of sanctions on banks not meeting capital requirements. If a bank has negative capital for three consecutive months, the authorized agency may, with the approval of the government, purchase the shareholders' interest on a compulsory basis and sell to new shareholders on condition intended to increase its capital and resumption of normal banking (Law on Banks and Banking, Article 16). Banks are required to report monthly on their capital adequacy.</p>
Assessment	Materially non-compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000 due to the absence of the calculation and application of capital adequacy ratios on a consolidated bank basis. Effective monitoring and enforcement of capital adequacy on consolidated bank basis (essential criteria 4) remains a serious concern given the prevalence of complex corporate structures. The recently introduced (July 2003) prudential requirements for groups is a good step to address this concern. However, it will require some time to determine whether these group-wide requirements will be effectively monitored and enforced in practice. While a legal foundation for the collection of information from subsidiaries and affiliates is in place, the lack of evidence of effective monitoring and enforcement of group-wide capital adequacy standards calls into question the ability to fulfill the intent of this principle. Currently, it is possible that accumulated losses in a subsidiary would erode the capital base of the bank on a consolidated basis without being reflected in the solo capital adequacy reports submitted by banks, notwithstanding the prudential provision that the investment in a subsidiary be deducted from the bank's capital base. Only with the effective implementation of group-wide capital adequacy standards can this concern be mitigated.</p>
Principle 7.	<p>Credit policies An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.</p>
Description	<p>Article 34 of the Law on Banks and Banking requires the Board of Directors or stockholders at a general meeting to approve the written credit granting policies and procedures of each bank. Banks' policies must, at a minimum, establish the conditions for granting of credit, the organizational structure, functions and power of the credit committee, as well as lending limits and credit approval procedures. Further prudential guidance on systems of risk management and internal controls had been provided through recommendations contained in NBK Resolution 116, April 2001, with binding requirements established by Resolution 434,</p>

	December 2003. Appendix 2 of Resolution 434 provides detailed guidance regarding the minimum requirements for acceptable credit risk management policies and procedures. The guidance is broad, providing a good indication to banks of the expected standard, and a useful yardstick for on-site examiners to use in evaluating the adequacy of a bank's policies and procedures.																																																
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Comments	This principle was assessed as largely compliant in 2000. The principal concern was that in practice, the supervisory authority focused too much on ensuring that policies and procedures were in place as opposed to an evaluation of the adequacy of the policies. The guidance provided in 2001 was a good initiative, and the standards established in Resolution 434 provide much more comprehensive guidance for banks than the earlier non-binding recommendations. This more comprehensive guidance goes some way to ameliorate concerns that examiners may focus more on the existence of banks' internal policies and procedures rather than assessing the adequacy and implementation of such policies and procedures (essential criteria 2, 3 and 4). The extensive guidance in Appendix 2 of Resolution 434 should provide a useful yard-stick for on-site examiners in assessing credit risk management. However, the assessment team still has some concerns about whether there is sufficient expertise within the on-site division to ensure that all inspections focus to the extent necessary on the evaluation of banks' policies, practices and procedures. Given the very recent introduction of the new resolution (December 2003), it is not yet possible to assess in practice the extent of compliance by banks and the use of the resolution in the on-site assessment the adequacy of banks policies and procedures. Effective implementation would enable Kazakhstan to become fully compliant with this principle.																																																
Principle 8.	Loan evaluation and loan loss provisioning Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.																																																
Description	<p>A new approach to loan loss provisioning was introduced with NBK Resolution 456 in November 2002. The previous rules had tended to be applied by banks in a formulaic manner, with the result that, although there was no preclusion of the exercise of judgment by banks to establish provisions in excess of the minimum required, in practice the provisions made by individual banks, and in fact the sector as a whole, was generally identical to the minimum required by the delinquency formula. The new resolution introduced a formula that explicitly considers factors such as the financial condition of the borrower and the quality of security held in addition to days in arrears. This approach is intended to lead to a more realistic estimate of the current realizable value of assets. The resolution covers both on-balance sheet and off-balance sheet items. Each asset is to be evaluated using a formula that sums values assigned to various characteristics of the investment, with positive values assigned for adverse characteristics, and negative values assigned for things that would mitigate potential losses (table below).</p> <table border="1"> <thead> <tr> <th colspan="4">Criteria</th> </tr> </thead> <tbody> <tr> <td colspan="3">Financial condition of borrower</td> <td>Scores</td> </tr> <tr> <td colspan="3">Stable</td> <td>0</td> </tr> <tr> <td colspan="3">Satisfactory</td> <td>+1</td> </tr> <tr> <td colspan="3">Unstable</td> <td>+2</td> </tr> <tr> <td colspan="3">Critical</td> <td>+4</td> </tr> <tr> <td colspan="4">Arrears</td> </tr> <tr> <td>Loans</td> <td>Inter-bank deposits, securities and contingent liabilities</td> <td>Receivables</td> <td></td> </tr> <tr> <td>1-30 days</td> <td>up to 7 days</td> <td>up to 14 days</td> <td>+1.5</td> </tr> <tr> <td>31-60 days</td> <td>7-15 days</td> <td>14-30 days</td> <td>+2.5</td> </tr> <tr> <td>61-90 days</td> <td>15-30 days</td> <td>30-60 days</td> <td>+3.5</td> </tr> <tr> <td>over 90 days</td> <td>over 30 days</td> <td>over 60 days</td> <td>+4.5</td> </tr> </tbody> </table>	Criteria				Financial condition of borrower			Scores	Stable			0	Satisfactory			+1	Unstable			+2	Critical			+4	Arrears				Loans	Inter-bank deposits, securities and contingent liabilities	Receivables		1-30 days	up to 7 days	up to 14 days	+1.5	31-60 days	7-15 days	14-30 days	+2.5	61-90 days	15-30 days	30-60 days	+3.5	over 90 days	over 30 days	over 60 days	+4.5
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Comments	<p>This principle was assessed as largely compliant in 2000. The main concern was that banks tended to use the formulaic days in arrears requirements rather than establishing provisions that reflected a realistic estimate of the realizable value of an asset (essential criteria 4, 5 and 9). It is not yet clear whether the new approach to loan loss provisioning will result in more realistic valuation of banks assets in practice, but it does reflect a good attempt to address one of the most challenging issues in banking supervision.</p> <p>The new approach to loan loss provisioning is a laudable attempt to establish a formula driven approach that would provide a reasonable approximation of realizable value. The overall effect for the banking system, evident in 2003, was to reduce the percentage of assets classified as “standard” and to increase the minimum provisions required. It is not clear whether the new approach provides a more accurate estimate of realizable value. However some fine-tuning of the approach would appear to be warranted. Unsecured personal loans almost inevitable attract a substandard classification, even if operating wholly as agreed. This makes credit card and personal line of credit lending particularly unattractive to banks, especially as the requirement to classify other exposures (for example mortgage loans) at the lowest level of any facility extended to the same borrower. Exclusion of unsecured loans up to a value commonly used in retail lending, or which are of a relatively small percentage of total exposure to the borrower, may be a way to deal with this concern. In the longer term, banks will develop statistical approaches to classify relatively homogeneous loans such as personal lines of credit and mortgages. While outside the control of the FSA, the assessment team recommends that all specific loan loss provisions required under the resolution should be deductible from income for tax purposes.</p>
Principle 9.	<p>Large exposure limits Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.</p>
Description	<p>NBK Resolution 213, June 2002, limits exposure to a single borrower to 25 percent of capital, or 10 percent of capital if the loans are unsecured. The definition of group exposure is suitably broad (Article 10 of the resolution), however there is no discretion for the supervisory authority to deem parties to be part of a single group when that is the substance of the relationship. Thus a legal structure that is not explicitly captured by the definition will fall outside the single borrower limit. The requirement for all large loans to be reported to the Credit Register maintained by the supervisory agency provides the means to identify sectoral and geographic concentrations within a bank’s portfolio.</p> <p>The introduction of consolidated reporting requirements in the banking law, including collection of data from the affiliates of banks, and the introduction of prudential limits for banking groups (Resolution 250, July 2003), provides a legal basis to apply large exposure limits on a group-wide basis. However, the assessment team did not see evidence to indicate that that these requirements are being effectively enforced and monitored at present. The supervisory agency is still developing its approach to consolidated supervision.</p>
Assessment	Materially non-compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000, largely because the absence of consolidated reporting and the inability to obtain information from affiliates and subsidiaries of banks raised serious questions about the ability to identify concentrations within the portfolio on a solo and group basis (essential criteria 3), and ensure that lending limits are not exceeded (essential criteria 4). There is now a legal foundation to achieve full compliance, but the recent introduction of consolidated prudential requirements, and the nascent state of the supervisory agency’s approach to consolidated supervision, means that evidence of effective implementation is not yet available. Successful progress with the FSA’s plans for consolidated supervision should result in progress toward full compliance.</p> <p>While not a requirement to meet full compliance with this principle, the assessment team also</p>

	<p>recommends that an aggregate limit on large exposures be introduced. The EU definition of large exposures as 10 percent of capital, and limiting all such exposures to 800 percent of capital is an example, but a lower aggregate limit should be considered.</p>
Principle 10.	<p>Connected lending In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.</p>
Description	<p>Exposures to a related party of a bank are restricted to 10 percent of capital (Resolution 213, Article 13). The aggregate of all such exposures cannot exceed total bank capital. Article 40 of the Law on Banks and Banking prohibits granting favorable terms to bank insiders, and specifically prohibits non-arm's length terms and unsecured lending. Insider advances must be approved by the board of directors. The definition of parties related to the bank is reasonably broad, and Article 17.1 (3) provides the supervisor with the ability to deem a party to be an insider if he is able to influence the decisions of a bank, even if the relationship evades the other definitions of related party.</p> <p>Banks are required to report monthly on insider exposures. These reports are said to be verified in on-site inspections, with staff indicating that they typically checking share registries and tracing beneficial ownership to verify full disclosure of parties related to the bank. In most cases examination staff is satisfied regarding their ability to identify beneficial ownership, although there are some specific instances where institutions in other jurisdictions have not provided the requested detail regarding beneficial ownership of nominee shares.</p>
Assessment	Largely compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000, largely due to concern that the volume of insider transactions was much higher than reported by banks, evidence of favorable terms and conditions provided to insiders in violation of the law, and exemptions from prudential limits granted by the board of the NBK. Very significant progress has been made since 2000. The NBK (and now the FSA) made extensive use of the revisions to the banking law requiring affiliates of banks to provide information for supervisory purposes. There is now a much higher probability that related parties will be identified by the supervisor even if not disclosed by the banks in their required reporting. The practice of providing exemptions from prudential standards has been stopped, and all banks are reportedly reporting compliance with prudential limits.</p> <p>The essential criteria of this principle are largely met, but achieving full compliance requires obtaining greater certainty over time that all related parties are actually identified and reported.</p>
Principle 11.	<p>Country risk Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.</p>
Description	<p>NBK Resolution 262, June 2000, requires that on a monthly average basis, banks invest their funds so that the ratio of domestic claims to total authorized capital plus subordinated debt plus domestic liabilities is equal to one. The extent of a bank's country risk exposure will thus be largely a function of its foreign funding, as use of domestic funding for investment abroad is effectively proscribed.</p> <p>Resolution 213 on prudential norms provides that the NBK (now the supervisory authority) can establish specific limits on currency exposure depending on the sovereign credit rating, or in the absence of a sovereign rating.</p> <p>The foreign exchange limit resolution considers country ratings in determining allowable open positions, and the capital adequacy requirements and asset classification requirements also</p>

	<p>incorporate specific consideration of country risk as reflected in ratings.</p> <p>Resolution 434 introduced in December, 2003, provides guidance with respect to the responsibilities of the board of directors in establishing policies and procedures for the management of country risk. Required elements include establishment of country risk assessment methods, periodic collection of information from external sources, and establishment of country limits.</p>
Assessment	Largely compliant.
Comments	This principle was assessment as non-compliant in 2000 as there were no explicit provisions to address country risk. The improvement to largely compliant is due to the various measures in the foreign exchange, capital adequacy and asset classification requirements that require banks to specifically reflect country risk exposure. Resolution 434 provides good guidance to banks regarding the necessary internal policies and procedures. Achieving full compliance requires effective implementation by banks of the requirements of this new risk management resolution (essential criteria 4).
Principle 12.	<p>Market risks</p> <p>Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor, and adequately control market risks; supervisors should have powers to impose specific limits and /or a specific capital charge on market risk exposures, if warranted.</p>
Description	<p>In 2001, banks were required to submit to the NBK reports by their external auditors on risk management practices. The NBK subsequently issued recommendations in Resolution 116 for risk management, including market risks. The guidance included broad requirements for the board of directors to ensure appropriate policies and procedures are in place. Resolution 434, introduced in December 2003 provides more detailed binding prudential guidance for risk management. Appendix three provides detailed requirements for the minimum acceptable standards for bank's policies and procedures with respect to market risk management, including establishment of appropriate limits for various types of market risk exposure, information and risk management systems to ensure compliance with the banks' internal policies, appropriate and timely back-office monitoring of positions, stress testing, and validation of internal systems. Daily mark-to-market is required. The level of development and implementation of risk management policies varies significantly among Kazakhstani banks.</p> <p>Foreign exchange exposure limits are established in Resolution 213, June 2002. Open positions (long or short) for currencies of countries with a sovereign rating of A or higher may not exceed 30 percent of capital. Short positions in currencies of countries with a sovereign rating of less than A but higher than B are limited to 15 percent of capital, with long positions limited to 5 percent of capital. Long or short positions in the currencies of countries with a sovereign rating of less than B, or unrated, are limited to five percent of capital. Net foreign currency exposure, defined as the difference between the total of all long foreign currency positions and the total of all short positions, is limited to 50 percent of capital. The resolution does not specify the treatment of items denominated in tenge but indexed to another currency, nor does it specify the treatment of options.</p> <p>The supervisory agency does have the ability pursuant to the banking law and Decree 1270 to issue prudential norms that could require capital to be held against market risks. To date, there is no requirement to hold capital against market risks.</p> <p>While on-site examinations do address risk management, the focus is largely on determining the existence of policies and procedures that meet the requirements of the banking law and relevant resolutions. There is considerable scope to enhance the focus on the adequacy and implementation of risk-management policies. The newly introduced prudential guidelines should assist in this regard, providing a good overview of the necessary minimum requirements for comprehensive risk management policies.</p>

Assessment	Materially non-compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000, due to the lack regulatory requirements consistent with the principles advocated in the BIS publication <i>Amendment to the capital accord to incorporate market risks</i>, and the general absence in banks of systems in place to adequately measure, monitor and control market risks.</p> <p>The prudential requirements established in Resolution 434 generally address most required elements of market risk management. One possible concern is that the requirement of the use of internal models may require a level of sophistication not found in the smaller banks. Consideration could be given to a simplified approach for banks with small market risk exposures. Also, the foreign exchange limits should specify that items indexed to foreign currency should be included in the long position of that currency, and there should be an explicit reference to valuing options (essential criteria 2).</p> <p>Evidence is not yet available to substantiate that banks have actually establish the market risk management processes required by Resolution 434 (essential criteria 1). These include setting appropriate limits (essential criteria 2), and scenario analysis and stress testing (essential criteria 12). The sample on-site work reviewed by the assessment team indicated there are still significant shortcomings in banks’ policies and practices, and discussion with market participants and the auditing community indicate that scenario analysis and stress testing is generally absent in the approach to risk management in Kazakhstani banks. Particularly in the case of medium-sized and smaller banks, there are more basic deficiencies, including the absence of effective internal limits on various positions, as well as widespread weaknesses in the systems for monitoring and control. While some banks are planning major software investments, the assessment team has some concern that purchasing software is viewed as a “silver bullet” rather than a means to implement and monitor policies and procedures, which must themselves be well founded.</p>
Principle 13.	<p>Other risks</p> <p>Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor, and control all other material risks and, where appropriate, to hold capital against these risks.</p>
Description	<p>The Law on Banks and Banking requires banks to maintain policies and procedures that comply with prudential norms addressing a wide range of risks, including liquidity risk, maturity and interest rate risk, and operational risk. Resolution 434 introduced in December 2003 provides good guidance to banks in many areas of risk management. Frequent reporting is required on all material risk exposures; however there is considerable scope to expand the analysis of various risks, and for the supervisory agency to introduce stress testing and scenario. The reporting of interest rate and maturity risks required by the NBK is not used as a management tool by the small banks, while some of the larger banks use more sophisticated analysis and only use the reports required by the supervisory agency to meet regulatory requirements.</p> <p>On-site examinations check for the existence of required policies and procedures, and review committee and board minutes to confirm proper reporting and oversight. The on-site work reviewed by the assessment team reflects limited analysis of funding sources, stress testing, and contingency planning. Similarly, the on-site and off-site review of interest rate risk is limited. The heavy use of dollar denominated loans as well as extensive use of wholesale funding, including Eurobonds, lends urgency to the need for more thorough risk analysis. There are no requirements for banks to include a statement on their risk management policies in their published statements.</p>
Assessment	Materially non-compliant.
Comments	The principle was assessed as materially non-compliant in 2000 due to inadequate requirements and practices with respect to the management of liquidity risk, interest rate risk

	<p>and operational risk (essential criteria 2.). Banks have made some progress in their risk management practices, and more detailed prudential guidance has been provided. The requirements of Resolution 434 are of a good standard, but it remains to be seen how effectively they will be implemented. The sample on-site work reviewed by the assessment team identified weaknesses in the systems for monitoring and controlling risks in banks (essential criteria 1). Also, despite the broad references to operational risk and interest rate risk in the non-binding prudential guidance that preceded the introduction of Resolution 434, the sample on-site work reviewed by the assessment team did not specifically examine these risks as part of a full-scope examination.</p> <p>There is scope for the supervisory agency to increase the depth of its analysis of various risk exposures. Priority should be given to liquidity management and refinancing risk (essential criteria 4 and 6) as the heavy dependence of Kazakhstani banks on wholesale funding means that there can be high risks arising from “lumpy” maturity profiles of wholesale funding, even when banks report full compliance with the prudential norms on liquidity. The supervisor should also have a very clear understanding of the legal structure of the special purpose vehicles used by banks to issue Eurobonds, in addition to being fully aware of the covenants, terms, and conditions of these instruments.</p>
<p>Principle 14.</p>	<p>Internal control and audit</p> <p>Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
<p>Description</p>	<p>Article 31 provides a good broad overview of necessary internal policies, procedures and controls, requiring that the board of directors approve all such measures. Further prudential guidance is provided in Resolution 112 (1998) on internal control, as well as with respect to various aspects of risk management in Decree 434 (December 2003). Voluntary corporate governance guidelines for Kazakhstani companies were issued in 2002.</p> <p>Existence and adequacy of internal controls and the operations of the internal audit function are reviewed during on-site examinations. The sample on-site work reviewed by the assessment team indicated a greater focus on compliance, that is, the existence of the required policies, procedures and controls, rather than an assessment of their adequacy and implementation by the banks. Article 54 of the banking law provides a legal basis for the supervisor to have access to all work of the internal audit function.</p> <p>Revisions to the banking law have introduced education and experience qualifications for senior officers of banks (Article 20), which should ensure adequate skills and staff resources for the audit and control functions.</p> <p>Full-scope examinations conduct a thorough review of the organizational structure, staffing, and qualifications of the internal audit department. An assessment of the independence of audit department, including reporting lines to the Board of Directors, is also completed. The on-site examiners verify the existence of appropriate internal control polices and procedures. The examiners also review the bank's audit plan and determine whether the objectives of the audit plan have been met. This includes a review of duties, responsibilities and lending limits. An assessment of management skills is also conducted at each comprehensive on-site examination.</p>
<p>Assessment</p>	<p>Largely compliant.</p>
<p>Comments</p>	<p>This principle was assessed largely compliant in 2000. Continued improvement in the application by banks of the requirements for internal control and audit is required to reach full compliance with this principle. The assessment team noted in samples of on-site work that</p>

	further progress is needed by banks to ensure that their internal controls are in fact adequate for the nature and scale of their business (essential criteria 2).
Principle 15.	Money laundering Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict “know-your-customer” rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.
Description	There is currently no specific law addressing anti-money laundering (AML) and combating the financing of terrorism (CFT), although such a law is in preparation. NBK resolution 266, June 2, 2000 establishes requirements for the opening and operation of bank accounts. Resolution 112 on internal control, May 1998, establishes a requirement for bank staff to report to the internal audit function large (T 1 million cash, or any inflow over T 5 million not properly documented) or suspicious transactions. Bank secrecy provisions impede reporting of suspicious transactions.
Assessment	Materially non-compliant.
Comments	<p>This principle was assessed as non-compliant in 2000. The improvement to materially non-compliant reflects the subsequent introduction of know-your-customer requirements, and evidence of their enforcement. While the existing resolution encompasses some of the requirements for a modern regime for prevention of use of banks by criminal elements, considerably more specific prudential guidance, together with specifically targeted on-site examination work to ensure that banks are appropriately implementing the necessary policies and procedures, is required to reach full compliance. The assessment team noted that significant attention was paid to the identification of customers as part of a full-scope examination, thus indicating that efforts are made to enforce the existing know-your-customer requirements.</p> <p>Specific requirements for the banking sector should be coordinated with the broader work on an AML law and creation of a financial intelligence unit (FIU) to ensure that the prudential requirements for banks are wholly consistent with the broader legal framework. More detailed and specific guidance needs to be provided to banks regarding the minimum requirements for acceptable internal policies and procedures (essential criteria 1). Revisions to the know-your-customer requirements will be required in future, but the current account opening regulations meet the minimum standard of essential criteria 2. Banks should be required to have a senior officer specifically responsible for compliance (essential criteria 4). Either through targeted on-site inspections, or as modules in full-scope inspections, the supervisory agency needs to verify that clear policies are clearly communicated to all bank staff for the reporting of suspicious transactions to the compliance officer or the appropriate law enforcement body (essential criteria 5 and 6), and that these policies are sufficient and consistently applied (essential criteria 9). Every bank employee reporting a suspicious transaction in good faith (essential criteria 8) should have legal protection.</p>
Principle 16.	On-site and off-site supervision An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
Description	<p>The new supervisory agency is in the process of revising the approach to on-site and off-site supervision previously employed by the NBK. The principal change is a movement away from a “solo plus” approach to consolidated supervision to an overall group approach. Previously, off-site analysis considered banks and banking groups, liaising as necessary with the other functional supervisors also domiciled in the NBK. On-site examinations were bank only, although relevant findings from the on-site work of the other functional supervisors were shared with banking supervisors.</p> <p>The FSA has established a division with specific responsibility for consolidated supervision. It is intended that this division will oversee financial groups, drawing on the work of the off-site analysis conducted by banking and the other functional supervisors, and coordinating</p>

	<p>simultaneous on-site examinations in the various regulated institutions belonging to single financial groups. Development of the necessary internal processes and procedures is still at an early stage.</p> <p>The existing approach to supervision has entailed good coordination between off-site and on-site work, with off-site findings being used to prioritize banks for on-site inspections, and in the planning and preparation of individual examinations. The NBK had an objective of examining all large banks annually and medium-sized banks not less than once every two years. In 2003, six full scope inspections were completed by the NBK. Ten full bank inspections are planned for 2004, although this plan was developed by the NBK and not the new agency, so the plan may be revised as the new agency develops and implements its revised approach to consolidated supervision.</p> <p>Banks are required to submit a wide range of prudential reports with frequencies ranging from daily to weekly, monthly, quarterly, and annually. The sheer volume of reporting raises questions about the ability of off-site staff to provide detailed analysis of all the data supplied by banks. The key reports for off-site analysis are quarterly balance sheet and income statements. Detailed quarterly reports are produced for each bank using the automated “BOSS” system. Monthly reports are also produced for banks requiring particular supervisory attention. These reports are all currently produced using “solo” data, although work has begun on developing an automated system to analyze consolidated data.</p>
Assessment	Largely compliant.
Comments	<p>This principle was assessed as largely compliant in 2000. The quality of off-site analysis has improved since 2000, with staff demonstrating greater knowledge of the banks they supervise and an ability to understand the underlying causes of changing financial ratios. The recent establishment of the FSA has resulted in some uncertainty regarding the ongoing management of the supervision function. Plans developed when supervision was part of the NBK are under review to reflect changes arising from the new organization for supervision, particularly as it relates to supervision of conglomerates. While there is no reason to believe that plans for management of the supervision function will not be effectively implemented, good progress on the many projects and plans underway in the new agency is required to fully meet essential criteria 4, ensuring that synergy is maximized and avoiding supervisory gaps.</p>
<p>Principle 17. Bank management contact Banking supervisors must have regular contact with bank management and a thorough understanding of the institution’s operations.</p>	
Description	<p>Regular meetings with bank management are held in conjunction with on-site examinations, which are scheduled partly on the basis of off-site risk assessment. The initial meeting with senior bank representatives is typically chaired by a senior official from the FSA. Off-site analysis staff typically is in contact with banks on at least a weekly basis regarding various aspects of off-site reporting and analysis. There is now a legal basis for the supervisory authority to meet with and require information from the affiliates of banks. The very comprehensive program of off-site reporting means that any breaches of prudential norms or adverse financial developments will come quickly to the attention of the supervisory authority. Bank management is assessed as part of the on-site examination process.</p>
Assessment	Compliant.
Comments	<p>The principle was assessed as largely compliant in 2000, with the main shortcoming being an inability for the supervisor to obtain a full understanding of banks on a consolidated basis. The concern has been addressed with the supervisory authority having made liberal use of the legal power introduced into the banking law to obtain information on related parties and affiliates of banks.</p>
<p>Principle 18. Off-site supervision Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.</p>	

Description	<p>The banking law, as well as Decree 1270 on the new supervisory agency, provides a legal basis for collection of all necessary data from banks on both a solo (Article 54 of the banking law) and consolidated basis (Article 54.1). In addition to the wide range of reports required on a solo basis, banks are required by Resolution 250, July 2003, to submit a quarterly report on capital adequacy and large exposures on a consolidated basis.</p> <p>Chapters 5 and 6 of the law on banks and banking provide the supervisory agency with the authority to establish accounting practices and procedures for banks, including consolidation. The format of consolidated account reporting required by the FSA may not be wholly consistent with IFRS, and there is room for greater consultation with the accounting profession in the development of reporting standards for banks.</p> <p>The supervisory agency can enforce a wide range of sanctions on banks and/or officers of banks for misreporting. In practice, the quality of reporting has improved significantly, and few sanctions have been required in recent years.</p> <p>Article 14 of the law establishing the supervisory agency provides a broad ability to obtain information for supervisory purposes. In practice, over [40] reports are obtained from banks on a routine basis, covering all key areas of off-site reporting.</p>
Assessment	Largely compliant.
Comments	<p>This principle was assessed as materially non-compliant in 2000, largely due to the lack of legal authority to collect consolidated data. This deficiency has been addressed, and since 2000 banks were required to submit consolidated data on an annual basis. This meets the essential criteria of this principle, which deals with consolidated reporting, but as noted in the discussion of principle 20, it falls short of the requirements for effective consolidated supervision. Despite the improvement in the depth of off-site analysis since 2000, there is still scope for improvement, for instance, with respect to liquidity management and funding as discussed in the comments to principle 13 (essential criteria 6). The assessment team reiterates the recommendation from the 2000 assessment that there be a full a review of the volume and frequency of data collection to ensure that it is commensurate with the size, activities, and risk profile of individual banks (essential criteria 8). The team is concerned that daily and weekly reporting and analysis, except in the case of identified problem banks, does not provide supervisory insights commensurate with the reporting burden on the industry and devoting of scarce analyst resources within the FSA.</p>
<p>Principle 19. Validation of supervisory information Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.</p>	
Description	<p>The examination planning process is not wholly settled due to the transition of supervisory authority from the NBK to the new agency. Currently, the FSA is working with the NBK plan of 10 full-scope examinations for 2004; however, there are also plans in development to revise the approach to examinations to involve coordinated on-site visits to all regulated parts of financial conglomerates. Six full-scope examination reports were completed in 2003.</p> <p>The banking law provides a broad ability for the supervisory authority to require information from banks (Article 54) as well as affiliates of banks (Article 54-1). Accuracy of off-site reporting is verified though on-site examinations, and external auditors are also required to attest to year-end prudential reporting as part of the annual audit. External auditors must be chosen from an approved list maintained by the NBK.</p>
Assessment	Compliant.
Comments	<p>This principle was assessed as compliant in 2000. Although the essential criteria, which relate primarily to having appropriate procedures in place for validation of supervisory information, are met, the assessment team is concerned that the small number of on-site examinations completed in 2003, and the current plans to inspect 10 banks during 2004 are insufficient to provide full comfort regarding off-site reporting. Completion of the plan for 2004 will result in</p>

	less than half of all banks having been examined over a two-year period, and additional supervisory resources may be needed to meet the FSA's objectives of examination systemically important banks annually and medium-sized banks on a two-year cycle.
Principle 20.	Consolidated supervision An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Description	<p>The Law on Banks and Banking provides a legal foundation for consolidated supervision. Article 54 expressly refers to reporting on a consolidated basis. Article 57 requires an annual external audit of holding companies and affiliates of banks, in addition to the bank itself. Article 47.1 provides for sanctions against holding companies or affiliates of banks, including requiring divestiture or dilution of an ownership stake. Consolidated group prudential standards (capital adequacy, single exposure, and related parties exposure) were introduced in 2003 (Resolution 250). Banks are required to submit consolidated financial information on a quarterly basis.</p> <p>The practical approach to consolidated supervision is still under development by the supervisory authority. With a single agency responsible for all financial sector supervision, there are no barriers to information sharing and coordination, however the necessary internal processes and procedures are still under development. Good progress has been made in identifying the overall structure of banking organizations, and the supervisors demonstrated a generally good awareness of the material parts of complex groups. At present, there is no regular or structured approach to assessing the risk that non-banking activities conducted within a conglomerate group may pose to the bank.</p>
Assessment	Materially-non compliant.
Comments	This principle was assessed as non-compliant in 2000. The improvement to materially non-compliant is a result of the legal revisions to provide an appropriate foundation for consolidated supervision. Further progress toward full compliance requires effective implementation of the FSA's plans to ensure the division responsible for consolidated supervision coordinates well with the functional supervisors in evaluating the risks posed to the group by non-banking activities (essential criteria 2 and 7). Effective monitoring and enforcement of the newly introduced prudential standards for banking groups is also required (essential criteria 5).
Principle 21.	Accounting standards Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.
Description	<p>Article 54 of the Law on Banks and Banking provides that the authorized agency, in conjunction with the NBK, can establish accounting policies and practices for banks, on a consolidated basis, consistent with international standards. Effective for the 2003 fiscal year, banks are required to use International Financial Reporting Standards (IFRS).</p> <p>Banks are required by Article 55 of the Law on Banks and Banking to publicly release their quarterly and annual financial statements. Annual financial statements must be audited by an auditor selected from those individuals or firms licensed by the authorized agency to undertake bank audits (Article 58) and the FSA may revoke the appointment of an auditor (Article 59).</p> <p>The new loan classification rules are a good attempt to ensure that assets are valued at an approximation of their realizable value. The application of IFRS from January 2003 has required banks to mark-to-market their trading book and assets available for sale.</p> <p>The FSA provides external auditors with instructions and formats for bank audits, but there is no legal duty for auditors to report to the supervisor matters of material significance.</p>
Assessment	Largely compliant.

Comments	<p>This principle was assessed as largely compliant in 2002. The assessment team reiterates the recommendation from 2000 that measures should be taken to ensure open lines of communication with auditors (essential criteria 4). These measures should include regular meetings (one or twice a year) with the accounting profession to discuss issues of common concern, as well as meetings as required to deal with issues related to specific banks. It is also important to consult with the accounting profession prior to introducing changes to accounting or reporting requirements and formats, and would be beneficial to consult regarding the practical impact of changes in IFRS, such as the expected revision to IFRS 39 (valuation of assets).</p>
Principle 22.	<p>Remedial measures Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.</p>
Description	<p>The supervisor has a broad range of remedial actions provided by Articles 46 to 48 of the banking law. Limited actions include the following: a Letter of Commitment, a Written Agreement, a Written Warning, and a Written Prescription with Binding Force. Sanctions include the following: penalty and fine, suspension or cancellation of license, closing the bank, revocation of a license, forced buyout or merger, and removal of bank officers.</p> <p>Since the introduction of deposit insurance at end-1999, five banks have had their licenses revoked and been placed in liquidation. Of these, only one was a member of the deposit insurance fund.</p> <p>Progressive use of supervisory sanctions has been demonstrated in the case of bank whose license to accept household deposits is currently under suspension. Efforts to obtain necessary supervisory information, including obtaining a written undertaking from the bank, did not have the desired effect, leading to license suspension in 2003.</p> <p>Actions of the supervisor may be challenged in court, but recent experience has been that supervisory actions have been upheld. This is attributed to increased knowledge of banking matters among the judiciary, which is now less inclined to overturn prudential decisions. Most legal challenges have related to liquidation procedures rather than remedial measures.</p> <p>The introduction of deposit interest rate ceilings by the deposit insurance fund in 2003 raises questions about the timeliness of supervisory action. Such ceilings were seen as necessary to prevent some banks paying excessive interest rates in efforts to attract funds. The assessment team is concerned that interest rates widely out of line with the market may well be indicative of banks experiencing liquidity and/or solvency problems. These issues would be much better addressed through prompt supervisory action rather than the indirect (and anti-competitive) measure of interest rate ceilings.</p>
Assessment	Largely compliant.
Comments	<p>The principle was assessed as materially non-compliant in 2000, largely due to the lack of evidence of timely response to identified problems in banks, and the reversal by courts of supervisory action taken by the NBK. The legal situation appears much improved, with a more knowledgeable judiciary having upheld supervisory decisions since 2000. Exemptions from prudential requirements are no longer granted by the supervisory authority. Banks with identified weaknesses are subject to more intensive monitoring, and all banks are currently reporting compliance with all prudential norms.</p> <p>Despite these improvements, the evidence of the introduction of deposit interest rate ceilings by the deposit insurance fund in 2003 gives the assessment team cause for concern. While the team was not provided with any off-site or on-site information indicating the existence of problem banks, it seems likely that banks resorting to paying interest rates well above the prevailing</p>

	market are suffering from mismanagement, illiquidity, and/or insolvency. The team understands that some banks have responded to the ceiling on interest rates by offering other incentives such as merchandise, health insurance, and lottery prizes. The team thus is concerned that the decision to introduce a ceiling on deposit rates and continued extraordinary measures by some banks to attract deposits may be evidence of problem banks not, in fact, being promptly identified and addressed (essential criteria 3).
Principle 23.	Globally consolidated supervision Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.
Description	The legal foundation for globally consolidated supervision is in place, since there is no impediment to using the same reporting and other supervisory requirements that can be employed in domestic consolidated supervision. There are no specific supervisory requirements to ensure that bank management maintains proper oversight of foreign establishments, or to determine that local management has the necessary expertise. The remedial measures provided in the law on banking (Article 46) could be used to require a bank to close or curtail the activities of a foreign establishment.
Assessment	Materially non-compliant.
Comments	This principle was assessed as materially non-compliant in 2000, primarily due to the lack of a legal foundation for globally consolidated supervision. Compliance with this principle was identified as a low priority in 2000 due to the limited international orientation of Kazakhstani banks. Oversight of foreign operations and affiliates of Kazakhstani banks is becoming much more important as five banks now have foreign establishments (ATF Bank, Centre Credit, Halyk Savings Bank, Kazkommerts, and Turan Alem), and several are planning further international expansion. The legal foundation is now in place, but the supervisory authority has not yet taken measures toward effective implementation. The supervisory agency should develop, as part of its on-site inspection process, a module explicitly focusing on bank management's oversight of foreign establishments. Similarly, there should be express consideration of foreign establishments in off-site analysis (essential criteria 3 and 4). Among other things, the FSA should require the parent banks to provide copies of key prudential returns provided to the host country regulator with respect to their foreign branches and subsidiaries, and consider whether on-site examinations should include visits to banks' foreign establishments.
Principle 24.	Host country supervision A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
Description	There are no legal impediments to meeting the essential criteria of this principle. A number of agreements have been established with foreign supervisors, providing a basis for exchange of information, and in some cases for the coordination of inspection activities. As a practical matter, there is little formal or informal contact or information sharing between the supervisory authority and the host supervisors in countries where Kazakhstani banks have establishments. The requirements of the banking law that banks obtain approval of the supervisory agency to open a branch or establish a subsidiary could be used to prevent establishing operations in countries where the flow of information is deemed inadequate for supervisory purposes.
Assessment	Materially non-compliant.
Comments	This principle was assessed as materially non-compliant in 2000, but as with principle 23, achieving compliance was identified as a low priority. Given the significant increase in international activity of Kazakhstani banks, it is now more important that the existing agreements with foreign supervisors develop into true working relationships, with a good two-way flow of information (essential criteria 1 and 3). This should include periodic verification of the accuracy of supervisory returns provided by parent bank with respect to the foreign

	operations, if these are not provided directly between the supervisory agencies pursuant to a memorandum of understanding. Other specific considerations should include exchange of examination findings and details of significant supervisory actions taken against either the parent or the foreign establishment, and possible coordination of on-site activities.
Principle 25.	Supervision over foreign banks' establishments Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.
Description	Local branches and subsidiaries of foreign banks are subject to the same prudential standards applied to local banks, although there are additional licensing requirements and some non-prudential restrictions (banks with foreign participation may not exceed 50 percent of the aggregate authorized capital of all banks in Kazakhstan unless approved by the authorized agency, and at least 70 percent of the employees of foreign banks must be Kazakhstani citizens). Prior to granting a license to a foreign bank, the foreign supervisor must confirm that the applicant is in possession of a valid banking license, is subject to consolidated global supervision, and that the home country supervisor is aware of the application for a license in Kazakhstan. There is no impediment to home country examiners visiting the Kazakhstani licensed subsidiary.
Assessment	Largely compliant.
Comments	This principle was assessed as largely compliant in 2000. There has been no material change, and the assessment team reiterates the recommendation that the regularity of contact should be increased, and stronger working relationships developed between the supervisory authority and various home country supervisors (essential criteria 6). The supervisory authority should also not rely on a simple assertion from home country supervisors that they exercise consolidated supervision (essential criteria 2), but should assess the home country's capacity for consolidated supervision.

Table 2. Summary Compliance of the Basel Core Principles and International Comparison

Core Principle	C ^{1/}	LC ^{2/}	MNC ^{3/}	NC ^{4/}		C ^{1/}	LC ^{2/}	MNC ^{3/}	NC ^{4/}
	2004 Assessment					Percent of assessed countries ^{5/}			
1. Objectives, Autonomy, Powers, and Resources									
1.1 Objectives		X				61	30	9	0
1.2 Independence			X			24	36	35	5
1.3 Legal framework	X					59	31	9	1
1.4 Enforcement powers		X				41	38	18	3
1.5 Legal protection	X					54	19	12	15
1.6 Information sharing		X				38	30	29	3
2. Permissible Activities	X					64	28	7	1
3. Licensing Criteria		X				37	46	14	3
4. Ownership		X				50	29	14	7
5. Investment Criteria		X				34	40	23	3
6. Capital Adequacy			X			29	36	34	1
7. Credit Policies		X				32	30	33	5
8. Loan Evaluation and Loan-Loss Provisioning		X				25	40	32	3
9. Large Exposure Limits			X			31	39	26	4
10. Connected Lending		X				22	33	35	10
11. Country Risk		X				24	14	17	45
12. Market Risks			X			21	23	33	23
13. Other Risks			X			13	33	36	18
14. Internal Control and Audit		X				33	28	28	11
15. Money Laundering			X			23	27	28	22
16. On-Site and Off-Site Supervision		X				30	45	24	1
17. Bank Management Contact	X					45	41	13	1
18. Off-Site Supervision		X				33	41	26	0
19. Validation of Supervisory Information	X					42	34	23	1
20. Consolidated Supervision			X			24	17	38	21
21. Accounting Standards		X				33	36	30	1
22. Remedial Measures		X				20	40	37	3
23. Globally Consolidated Supervision			X			34	28	25	13
24. Host Country Supervision			X			37	35	18	10
25. Supervision Over Foreign Banks' Establishments		X				46	32	17	5
Average, percent	17	53	30	0		35	33	24	8

^{1/} C: Compliant.

^{2/} LC: Largely compliant.

^{3/} MNC: Materially non-compliant.

^{4/} NC: Non-compliant.

^{5/} Based on 78 assessments. Please note that some principles, particularly principle 11, 20, 23, and 24 are not applicable in some jurisdictions. The coverage is thus less comprehensive for these principles.

Recommended action plan and authorities' response to the assessment

Recommended action plan

16. It should be stipulated in law that high level officials at the FSA can be removed only for cause with the reasons made public.

17. The most important measure to enhance Kazakhstan's compliance with the Core Principles is the effective implementation of initiatives already underway. Key among these are:

- completion of the "launch phase" of the new supervisory agency, including implementing the new agreement with the NBK, filling staff vacancies, and finalizing the near-term management plan for banking supervision;
- achieving effective consolidated supervision; and
- implementation of the risk management requirements introduced in December 2003.

It is not yet clear whether the authorized complement of 300 staff members for the agency is appropriate. As an initial step, existing vacancies should be filled and an analysis undertaken as to whether this provides sufficient staff resources to implement fully adequate on-site and off-site supervision, including the new approach to financial conglomerates. The FSA's budgetary autonomy must be ensured.

18. A legal foundation is now in place for consolidated supervision, prudential requirements were introduced on a group basis in 2003, and the FSA is working on its internal processes for the division responsible for conglomerate supervision to coordinate with the functional supervisors. While plans already exist to revise the existing regulations establishing prudential requirements for financial groups, the assessment team recommends a near-term focus on implementation of the existing framework before further legal revisions are considered in this area.

19. The assessment team recommends that in the near term the authorities focus scarce resources on evaluating the risk management policies and procedures of banks rather than on developing capital adequacy requirements for market risk. While larger banks require intensive attention due to their greater systemic importance, small banks also require attention as they are generally less well positioned to introduce the needed policies and systems. Technical assistance could be useful in helping to raise the overall standard of bank risk management practices, and also to develop the capacity of the FSA staff to understand and evaluate various market risks.

20. The assessment team recommends that the FSA focus special supervisory attention on any banks using extraordinary measures, such as offering merchandise or lottery prizes, to attract deposits. These could be indicative of emerging problems, and in the presence of interest rate ceilings, the FSA does not have at its disposal the direct indicator of banks

paying rates well above market rates. The administrative limit on deposit rates should be removed.

21. One area where significant changes to the legal framework are still required is the prevention of the use of banks by criminal elements. An anti-money laundering law should be introduced, establishing a Financial Intelligence Unit (FIU), and the current bank secrecy provisions should accordingly be amended. Specific prudential guidelines for banks in conjunction with broader work on anti-money laundering/combating the financing of terrorism (AML/CFT) issues should be prepared. The FSA should be fully engaged with the Ministry of Justice, the Agency for the Fight Against Economic and Corruption Crimes, the NBK, and other agencies in the development and introduction of this law.

22. While outside the control of the FSA, it would be helpful if there was a broad review of fiscal policies affecting the financial sector. In particular, the assessment team is concerned about the distortionary effects of the limit on interest paid that banks can deduct from income for tax purposes. This has the perverse effect of causing higher loan rates as banks seek to earn an equivalent after-tax return for shareholders, and could ultimately weaken asset quality as borrowers bear the brunt of higher loan rates. The team also recommends that all specific provisions required to comply with the asset quality resolution should be deductible from income for tax purposes.

Authorities' response

23. The authorities were broadly in agreement with the assessment, and found it unbiased and useful. The authorities have recently issued regulation on consolidated supervision and risk management, but agreed that insufficient time had passed to assess the implementation and effectiveness of these regulations. The authorities aim at bringing prudential regulation up to EU standards by 2007.

II. UPDATES OF PREVIOUSLY ASSESSED STANDARDS AND CODES

24. A comprehensive update means that changes in the regulatory framework and its implementation since the 2000 assessment are documented for each principle, but the respective principles are not rated. The methodology for assessing compliance with, respectively, the International Organization of Securities Commissions' (IOSCO) Principles for Securities Regulation and for the International Association of Insurance Supervisors' (IAIS) Insurance Principles have been amended since the 2000 assessment, which is likely to affect the rating. An update of the Core Principles for Systemically Important Payment Systems and the Code of Good Practices on Transparency in Monetary and Financial Policies means that changes in the regulatory framework and recent developments are briefly discussed.³

A. Update of the IOSCO Principles on Securities Regulation

25. The Objectives and Principles of Securities Regulation (IOSCO Principles) issued by IOSCO offer benchmarks for comparison and assessment of adequacy and comprehensiveness of a regulatory framework for securities markets and its participants. The IOSCO Principles consist of three objectives and 30 principles, which are divided under eight headings reflecting a comprehensive coverage of securities regulation. Below is an update of the 2000 assessment of compliance with the IOSCO Principles.⁴ Since it is an update, the objectives and principles have not been rated, but progress and setbacks have been documented.

26. The 2000 FSAP concluded that the core legal infrastructure of the securities market was in place, but that the regulatory framework was weak. In particular, it recommended: (i) strengthening enforcement powers; (ii) restricting and disclosing transactions among affiliated parties, as appropriate; (iii) strengthening accounting and auditing standards; (iv) improving standards and process for licensing self-regulatory organizations (SROs); and (v) establishing sufficient capital requirements for intermediaries.

27. Since the 2000 FSAP, Kazakhstan has made a marked improvement in several aspects of the written legislation. The following laws were enacted in 2003:

- The Law on Joint Stock Companies (May 2003);
- The Law on Amendments and Addenda to Some Legislative Acts of the Republic of Kazakhstan on Securities Market and Joint Stock Companies (May 2003); and

³ In addition to the *Basel Core Principles for Effective Banking Supervision*, the following standards and codes were assessed during the 2000 FSAP: *IOSCO Principles on Securities Regulation*, *IAIS Insurance Principles*, *Core Principles for Systemically Important Payment Systems*, and the *Code of Good Practices on Transparency in Monetary and Financial Policies*.

⁴ The update was prepared by Rama Seth (World Bank consultant).

- The Law on the Securities Market (July 2003).

28. The new laws are ambitious. Their effective implementation by the regulator could help the industry develop. They provide the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Financial Organizations (FSA) with a clear and consistent regulatory framework; enforcement powers; authority to institute sanctions, promote transparency, prohibit manipulation and other unfair trading practices; provide clear objectives, functions, responsibilities, powers and authorities of self-regulatory organizations (SROs); and increase capital requirements for the central securities depository (CSD). It is too soon, however, to assess how effective implementation will be.

Principles for the regulator

Principle 1: The responsibilities of the regulator should be clear and objectively stated.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: Effective January 1, 2004, the FSA became the single supervisor and regulator of the Kazakhstani financial services industry comprising banks, nonbank financial institutions, insurance companies, pension funds, and the securities market. The 2003 Presidential Decree on “Regulations on Financial Market and Financial Organizations Regulatory and Supervisory Authority”(Regulation), Securities Market Law (SML) (Article 3), and Financial Market and Financial Organizations Government Regulation and Supervision Act (FMRA) (Articles 3, 8–15) issued in 2003 provide clear objectives, functions, responsibilities, and authorities of the FSA. The Regulation defines the structure and organization of the FSA, describes the structure of the board, and the appointment of the members, and provides that the Board be the highest governing body of the FSA.

Principle 2: The regulator should be operationally independent and accountable in the exercise of its functions and powers.

2000 Assessment: This principle was deemed to be observed.

2004 Observation: The structures of the FSA and the board as described in the Regulation exhibit a high degree of operational independence. The FSA reports directly to and is accountable to the President of the Republic. The FSA is not a structural branch of the government and hence is not accountable to the latter. Neither is it accountable to or formally dependent on the National Bank of Kazakhstan (NBK), except that the NBK provides the budget and some logistical support. The majority (four members) of the seven board members are directly associated with the FSA. One representative each of the president’s office, the NBK, and the government are members of the board. Reports to the president are to be published. There are no supervisory fees collected by the FSA, which ensures commercial independence, but consideration is being given to collect such fees with a view not to ensure budgetary autonomy. Currently, the budget of the FSA is a part of a budget of the NBK, which has its own budget separate from that of the state. This separation ensures

the staff a degree of independence from political influence, but the FSA's full budgetary autonomy should be ensured. The members of the FSA board are "political servants," and criteria for removal are specified in Article 26 of the Law on Public Service, but the president ultimately defines the base and the order of dismissal of political civil servants.

Principle 3: The regulator should have adequate powers, proper resources, and the capacity to perform its functions and exercise its powers.

2000 Assessment: This principle was found to be largely observed. The National Securities Commission (NSC) had the power to carry out surveillance of the market and to obtain relevant information from the NBK, ministries, state committees, and other bodies as well as issuers, market participants, and SROs including the Kazakhstan Stock Exchange (KASE). However, as noted under the section on Enforcement (Principles 8–10), it lacked adequate enforcement powers which was being addressed by amendments to the Administrative Code. The NSC could cooperate with foreign regulators by formally exchanging Memoranda of Understanding (MOU). The NSC was funded by the state budget with staff salaries paid by the NBK. The very thin market of corporate securities made it difficult to judge the adequacy of the NSC's resources. However, its inability to file properly and make available issue information (i.e., prospectuses) for review by investors raised concerns. The assessment found that the introduction of an electronic filing and disclosure system should be considered.

2004 Observation: The FSA has a mandate to directly carry out surveillance of the market. It has power to obtain any relevant information from the NBK, ministries, state committees, and other bodies as well as issuers, market participants, SROs, stock exchanges, and over-the-counter (OTC) trading systems. The SML also empowers the FSA to cooperate with foreign regulators and coordinate activities to try to prevent violations in the securities market or other issues of mutual interest. Moreover, it is also required to file and make available issue information (i.e., prospectuses) for review by investors as suggested in the 2000 assessment. An electronic filing and disclosure system is being considered.

Currently, a staff of about 30 individuals in the FSA, (about 10 each in the on-site and off-site divisions), are designated to the supervision of the capital market participants (a group of about 120), each of whom reports at different frequencies. Included are 52 broker-dealers, 19 share registrars, 10 custodian banks, 10 asset management companies, 16 pension funds, 2 SROs, 1 stock exchange, and 1 central securities depository. A disproportionate share of resources will increasingly be required in monitoring pension funds, owing to their rapid accumulation of funds as well as their social and fiscal importance. This could lead to a scarcity of resources when overseeing the rest of the securities market.

Principle 4: The regulator should adopt clear and consistent regulatory processes.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: Powers to make or adopt substantive and procedural rules and regulations as well as to ensure that regulations and procedures are consistently applied, comprehensible, fair and equitable, are specified in the Regulation, SML, and FMRA. Extensive internal rules and operational procedures, codified in the new law formalize previously existing regulatory practice and procedures. Enforcement procedures also offer intermediate steps (e.g., request for explanation, warning, administrative action, penalties, etc.).

In practice, however, not all steps and procedures of the new laws are fully understood by market participants. Some do not see the difference between the new and the old regime, and understand it to be “business as usual.” The more sophisticated participants have noted various changes as well as inconsistencies arising particularly from holding more than one type of license. Moreover, bylaws and detailed procedural guidelines have not yet been issued to accompany the new laws creating some confusion in market participants. Although the FSA solicits views from the industry, it would further benefit from a continuous dialogue with market participants, in addition to responding to their questions and requests for clarifications in a timely manner.

Principle 5: The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.

2000 Assessment: This principle was found to be observed.

2004 Observation: The staff of the FSA observes high professional standards, including those of confidentiality. As civil servants, the FSA staff has to meet requirements that have been established for administrative and political employees in Kazakhstan, including those of higher education and appropriate work experience. The guidelines for staff compensation established by the NBK provide competitive packages to attract specialists to the FSA.

All the employees sign employment contracts, which provide for due diligence and observance of confidentiality standards with respect to the information obtained during the course of exercising their powers and discharging their duties. Chapter 8 on Official and Commercial Secrecy and Chapter 19 on Information on Securities Market of the SML specify confidentiality requirements for FSA staff. Some countries have found it useful if staff disclose their financial interests to prevent conflicts of interest.

Principles for self-regulation

Principle 6: The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.

2000 Assessment: This principle appears to have been largely observed. The Kazakhstan Stock Exchange was the only “statutory” SRO recognized under the Securities

Markets Law (SML). Under an amendment to the SML, the KASE took over the self-regulatory responsibilities of the dormant broker-dealer association and regulated the off-the-exchange market. On the basis of the 1997 SRO Regulation, the NSC licensed the Association of Asset Management Companies (AAMC) with its seven members, and the Kazakhstan Registrars' Association (KRKCA) with its 24 members, as SROs. Use of self-regulation is encouraged where an SRO exhibits "credible" competency. However, both the AAMC and the KRKCA appeared to lack capacity and credibility to perform this role.

2004 Observation: Mandatory participation of licensed professional market participants in their relevant SRO was previously recommended and subsequently introduced in the 2003 Principles for the Enforcement of Securities Regulation. According to the new SML, however, stock exchanges are no longer statutory SROs; the KASE—which is a joint stock company with the NBK (majority shareholder), banks and other participants as shareholders—has subsequently opted to cede even its nominal status as an SRO.

Another softening from the previous legislation is the fact that the FSA cannot license an SRO, but it can confer an SRO status in the event that at least half of the relevant market participants are members of the SRO. Previously, in compliance with the Regulation on Self-Regulatory Organizations of Securities Market Professional Participants (the SRO Regulation) issued in 1997, the NSC licensed the Association of Asset Management Companies (AAMC) and the Kazakhstan Registrars' Association (KRKCA) as SROs. In practice, however, the KASE has—since the SML was passed—taken initiatives to be more responsive to the FSA's needs. For instance, a market surveillance system is currently being developed.

The AAMC and the KRKCA continue to lack the capacity, credibility, and will to develop as SROs. One problem arises from the fact that the members and interests they represent are diverse. Another constraining factor arises from the fact that the SML empowers the FSA to demand information disclosure, and participants are averse to inspections by their competitors.

Principle 7: SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

2000 Assessment: This principle was found to be materially non-observed. The KASE was the only functioning SRO and the AAMC had limited capacity and resources to act as an SRO.⁵ The KRKCA even appears to lack credible potential to be an SRO.⁶ The AAMC did not have a Code of Professional Conduct or credible capacity to impose such

⁵ For example, the AAMC is a sub-structure of the Association of Financiers of Kazakhstan (AFK) which represents the entire financial industry in the Republic. The AAMC does not have any staff of its own and relies on the AFK for logistical support.

⁶ Consolidation of the registrar industry into one centralized entity (and possible eventual integration with the CDS) is currently being discussed informally. In other words, the industry itself may possibly disappear.

rules onto its members. The NSC did not provide specific competency requirements and did not conduct supervision of compliance with such requirements by the licensed SROs. Therefore, development of effective supervisory standards and procedures for SROs was not found. The proposed mandatory participation of licensed professional market participants in their relevant SRO would help enhance credibility of the SROs. But formal SRO status should be granted only against demonstrated capability and credibility, and that the process of granting the status (with transitional status) should be used to encourage potential SROs to strive to enhance their capability and credibility in specific self-regulatory functions. The assessment suggested that the NSC might wish to develop a comprehensive policy and strategy for authorization and supervision of SROs.

2004 Observation: As suggested by the 2000 assessment, Chapter 18 of the SML provides clear objectives, functions, responsibilities, powers and authorities of an SRO. The SML determines an SRO's legal status, requirements and relationship with the regulatory authority. Under Article 94 of the SML, internal documents of an SRO shall include inspection and arbitration regulations, rules and standards of professional activity and ethics of the member participants. Internal documents of an SRO are subject to approval by the FSA. The SML empowers the FSA to demand information. Chapter 8, Official and Commercial Secrecy and Chapter 19, Information on Securities Market, of the SML determine confidentiality standards for SRO staff.

In practice, however, the current SROs have very limited capacity and resources.⁷ If any reasonable competency requirements are now set up for authorization and supervision of an SRO, it is likely that neither the AAMC nor the KRCCKA would qualify. Therefore, the previously recommended development of effective supervisory standards and procedures for SROs is still not in place.

Principles for the enforcement of securities regulation

Principle 8: The regulator should have comprehensive inspection, investigation and surveillance powers.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: Under Chapter 20, Supervision of Securities Market Participants, (Articles 108–112) of the SML, the FMRA, and the Regulation provide inspection, investigation, and surveillance powers of the FSA with respect to various professional market participants, stock exchanges, over-the-counter (OTC) trade systems, SROs, issuers, and training centers. It is still difficult to police the market effectively, when it is so illiquid, and trades are arranged outside the exchange. Moreover, the KASE does not yet have its own market surveillance system.

⁷ For example, the AAMC is a sub-structure of the Association of Financiers of Kazakhstan (AFK) which represents the entire financial industry in the Republic. The AAMC does not have staff of its own and relies on the AFK for logistical support.

Principle 9: The regulator should have comprehensive enforcement powers.

2000 Assessment: This principle was found to be materially non-observed. In the course of its regular inspections, the NSC found violations of the law and regulations. It had the power to suspend or revoke licenses of market participants and licensed SROs. In the case of issuers, the NSC can refuse, suspend or annul registration of an issue and disapprove a prospectus. However, it had no power to impose administrative sanctions directly. If any action fell within the definition of administrative offense under the Administrative Offenses Code, the NSC had to submit records of such offenses to the local Internal Affairs Department, before the offender could be called before the proper administrative body. NSC's discretionary judgment seemed hampered by the way laws are defined and interpreted. At the time of the assessment, amendments to relevant law and regulations were being worked out to strengthen the NSC's enforcement power.

2004 Observation: Significant strides have been made in the regulator's enforcement power, which enable it to impose administrative sanctions including financial penalties. In case of offenses by professional market participants, the FSA is empowered to suspend or revoke licenses, impose penalties, recall approval of senior managers and reexamine certified specialists. Revocation of a license requires a six month suspension and approval by the board. In the case of issuers, the FSA can refuse registration of the issue, suspend placement, and disapprove reports on placement and maturity. All sanctions imposed by the FSA can be challenged only through the court. Additionally, these sanctions are to be publicized by the FSA. If any action falls within the definition of administrative offense under the Administrative Offenses Code, the FSA must submit records of such offenses to the local Internal Affairs Department to be filed in the administrative office's records so that the offender can be called to the proper administrative body or appeal to other government authorities (General Prosecutor's Office, Tax committee, Ministry of Justice and Ministry of Internal Affairs). The FSA can refer matters to criminal authorities.

Principle 10: The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

2000 Assessment: This principle was found to be materially non-observed. In September 1999, the NSC adopted instructions on conducting inspections on: (i) the securities market's subjects to check validity of their licenses and observance of the effective legislation; and (ii) issuers. These instructions also provided sanctions for certain offenses. All sanctions imposed by the NSC can be challenged only through the court. The NSC conducts periodic, routine inspections as well as causal inspections whose results are reflected in their quarterly and annual reports. As stipulated by regulation, the annual reports are published. In reality, however, it appeared that the NSC does not sanction wrongdoing by issuers, for example, unless complaints are filed by investors. The reluctance of joint stock companies to go public and strict sanctions against issuers appeared to undermine the market changes to develop, making the NSC reluctant to impose sanctions. The assessment noted that a new law to protect small businesses appeared to prevent the NSC from suspending or

revoking a small enterprise's license since many broker-dealers and most registrars were small enterprises.

2004 Observation: Instructions determine the procedures for conducting inspections, as noted in the 2000 assessment. The FSA provides sanctions for certain offenses; all sanctions imposed by the FSA can be challenged only through court. The FSA can conduct periodic, routine inspections as well as causal inspections and joint inspections with other government authorities (e.g., tax authorities, internal affairs authorities, prosecutors).

While the environment is still one of reluctance on the part of joint stock companies to go public, the FSA is hesitant to impose strict sanctions against issuers for the same reasons as noted in the 2000 assessment. Moreover, the former law's protection of small businesses through the prevention of issuance of sanctions against broker-dealers and registrars—most of them were small enterprises—has effectively been superseded by the new law's high capitalization requirements.

The FSA now can sanction wrongdoing if complaints are filed by investors, the stock exchange, registrars and nominal holders (not beneficial owners), and additionally if the registration and approval process reveals violations. In practice, however, surveillance by market participants is severely lacking and no violations are expected to be reported by market participants.

Principles for cooperation in regulation

Principle 11: The regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: The FMRA, the Regulation, and Clause 3 of Article 43 of the SML provide that the FSA has a right to request and receive information required for its activity in the securities market from government authorities, issuers, licensees and SROs. The SML determines what information is to be disclosed publicly by the FSA. Chapters 8 on Official and Commercial Secrecy and 19 on Information on Securities Market of the SML determine the information, which is not a subject of disclosure. The FSA is empowered to cooperate with foreign regulators, share information, and coordinate activities in the area of prevention and avoidance of violations in the securities market or in other issues of mutual interest. Limitations existing in the previous law appear to have been removed, since at present even information determined as official or a commercial secret can be disclosed to a foreign regulatory authority in accordance with a ratified agreement. Other nonpublic information can be disclosed without any agreement.

Principle 12: Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: The FSA is required by new Regulation to disclose public information, including the FSA's rules and regulations, information on issuers and issues, sanctions enforced, and information on licensees. Currently, this information is disclosed on the FSA's website (www.nsc.kz). Some progress appears to have been made in establishing mechanisms to share nonpublic information with domestic and foreign regulators. Information determined as official or a commercial secret can be disclosed to a foreign regulatory authority in accordance with the agreement ratified; other nonpublic information can be disclosed upon request. Information to the government authorities is to be disclosed upon receipt of a request in accordance with government authorities' rules. Currently, the FSA is preparing an MOU for ratification procedures. MOUs are not yet in place with foreign regulators, but the FSA collaborates with the Russian authorities.

Principle 13: The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

2000 Assessment: This principle was found to be materially non-observed. Although the NSC was allowed to cooperate with foreign regulators within the above-stated limitations, they did not appear to have established procedures for providing assistance in: (i) obtaining voluntary cooperation from those who may have information about the subject of an inquiry; (ii) obtaining documents, statements or oral testimony; (iii) providing information on regulatory process; and (iv) obtaining court orders. (See also Principle 11.)

2004 Observation: Limitations to cooperate with foreign regulators have been eased. The FSA is empowered to share information, cooperate with foreign regulators and coordinate activities in the field of prevention and avoidance of violations in the securities market or in any other issue of mutual interest. Information determined to be official or a commercial secret can be disclosed to a foreign regulatory authority in accordance with the agreement ratified; other nonpublic information can be disclosed upon request. Procedures still need to be clarified for providing assistance in the four areas cited in the 2000 assessment.

Principles for issuers

Principle 14: There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions.

2000 Assessment: This principle was found to be materially non-observed. The Securities Market Law provided for full and fair disclosure of information about securities issue and issuer, however, periodic disclosure was required only for public joint stock companies, of which there were only a few dozen. Most were not open public joint stock companies and, therefore, were not required to provide periodic disclosure. The 2000

assessment recommended prudentially formulated disclosure requirements regarding management conflicts of interest. The NSC was strongly encouraged to create an electronic filing and disclosure system for registered offerings and periodically reported information. Shortcomings included anomalies in the registration requirements for securities, loopholes in the rules to exempt closed offerings of joint stock company shares from registration, and the absence of a law restricting resale of unregistered issues or requiring periodic reporting unless joint stock company shares were involved.

2004 Observation: Articles 101–107 in Chapter 19 of the SML provide for full and fair disclosure of information about a securities issue and issuer. The Shares Issue Rules and Bonds Issue Rules adopted in 2003 require registration and public disclosure of changes in significant items of prospectuses. These rules significantly widen the information to be disclosed in a prospectus, including information on capitalization and indebtedness, observation of risk factors, the history and development of the company, operating results, trend information, information on directors and senior management, dividends and paying agent, patents, etc. Periodic disclosure is required for listed companies and joint stock companies, all of which are now considered public, since the new joint stock company act no longer allows for closed joint stock companies. Hence, loopholes arising from earlier rules to exempt closed offering of joint stock company shares from registration are avoided. The minimum capital requirement of joint stock companies has been made higher and smaller companies that could in the past be considered joint stock companies are now limited liability companies.

Electronic filing and disclosure system for registered offerings and periodically reported information is under consideration.

Principle 15: Holders of securities in a company should be treated in a fair and equitable manner.

2000 Assessment: This principle was found to be materially non-observed. The Joint Stock Company Act provided that a common share would afford each shareholder the same rights as provided to other owners of common shares and that voting at a general shareholders' meeting would be performed on the basis of "one share–one vote." The NSC could discover breaches of the articles by inspection and restore shareholders' rights and interests. The Securities Market Law included insider trading provisions. However, civil procedures did not appear to provide for class action. While the Joint Stock Company Act provided for tender offers, an NSC rule required broker-dealers to conduct securities transactions only through the authorized stock exchange (KASE). The 2000 assessment called for changes to the rule or stock exchange procedures to accommodate tender offers. The Joint Stock Company Act provided for cumulative voting to elect minority directors; however, this was made ineffective by the rule of removal of directors by a simple majority, effectively ensuring that majority shareholders could put directors of their choice on the board.

2004 Observation: The new Joint Stock Company Act maintains that a common share shall provide each shareholder with the same amount of rights as is provided for other owners of common shares and that voting at a general shareholders' meeting shall be performed on the basis of "one share-one vote." The FSA can discover breaches of the articles by inspection and restore shareholders' rights and interests. The Financial Services Customer Protection Department of the FSA does provide customer and investors with qualified consultation and informs the relevant Inspecting Division. The Joint Stock Company Act also provides for cumulative voting to elect minority directors and the problem of majority voting limiting minority directors may have been removed.

Principle 16: Accounting and auditing standards should be of a high and internationally acceptable quality.

2000 Assessment: This principle was found to be materially non-observed. Twenty-nine accounting standards based on IAS had been adopted. Ironically, these seem to be creating a greater incentive to hide profit and avoid taxes. International Auditing Standards had not been adopted, although they were in the final stage of consideration.

2004 Observation: Financial organizations in Kazakhstan have been implementing International Accounting Standards (IAS, now International Financial Reporting Standards, IFRS) from 2003, while nonfinancial entities will start IAS implementation in January 2005. In 2003, Kazakhstan Auditing Standards were recognized to be invalid, and International Standards on Auditing (ISA) have since been applied. In practice, however, only the larger institutions are able to apply IFRS. The smaller ones perceive that they have been given a reprieve, since there is a migration schedule in place for transitioning to IFRS. Moreover, the tax office will also require some transitioning time. Furthermore, "marking-to-market" is not currently particularly meaningful, since the market is illiquid.

Principles for collective investment schemes

Principle 17: The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: Only asset management companies can manage an investment fund's assets. Therefore, operators of collective investment schemes are subject to regulation, supervision and enforcement by the FSA.

Principle 18: The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.

2000 Assessment: This principle was found to be materially non-observed. Although the Investment Fund Act provided a legal framework and structures for mutual funds, the

definition of “affiliated persons” and conflicts of interest in related party transactions was too narrowly defined. Considering the size, growth and social importance of pension funds, which are managed by asset management companies licensed and regulated by the NSC, the inadequate control of potential principal-agent problems seemed to generate a major potential vulnerability for the economy in medium-term. The Pension Act has broadened the definition of affiliated persons to include “anyone with a right directly or indirectly to influence the decisions of the other, even if the right arises only by informal agreement.” Under the Pension Act, the custodian monitors compliance of fund investments with the asset allocation rules applicable with them. The assessment recommended that the Investment Fund Act adopt similar provisions. Clearly, the custodian’s affiliation with the asset management company should be controlled appropriately.

2004 Observation: A new Investment Funds Act was introduced to Parliament recently (January 8, 2004). In practice, however, no new investment fund has been operating in the securities market since December, 2000. For instance, banks that act as investment managers of pension funds are required to use another bank as the custodian bank.

Principle 19: Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor’s interest in the scheme.

2000 Assessment: This principle was found to be materially non-observed. The suitability requirement was provided in Investment Fund Act. As fiduciary organizations, however, collective investment schemes should be required to avoid conflict-of-interest transactions; when these exist, the collective investment schemes must at least be required to disclose the transactions. Both investment and pension funds must be organized as joint stock companies subject to certain disclosure and shareholder approval requirements for “conflict-of-interest transactions.” The definition in law of conflict-of-interest transactions seemed to include those among blood relatives. In the case of pensions, shareholder approval of conflict-of-interest transactions would provide little protection, since the pension shareholders were the sponsors not the beneficiaries under the Pension Act. In the case of investment funds, the Investment Fund Act, specifically designed to regulate the vehicles, may be used to over-rule the Joint Stock Company Act, potentially creating a situation where conflicts would be less tightly controlled in a fiduciary organization than in an ordinary commercial entity.

2004 Observation: The new Investment Funds Act was introduced to Parliament recently (January 8, 2004). In practice, however, no investment fund has been operating in the securities market since December, 2000. Conflict of interest issues pointed out in the previous FSAP, have been addressed.

Principle 20: Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

2000 Assessment: This principle was found to be materially non-observed. Valuation of the collective investment schemes' portfolios in an illiquid market was and is difficult. At the time of the assessment, a committee, under the auspices of the NSC, composed of market professionals was working on establishing a calculation methodology. In establishing a methodology, provision for when it can be revised in response to changes in the market environment (i.e., introduction of new instruments, increase of liquidity, etc.) would be needed as well. Changes in methodology tend to generate a systemic impact on the value of investment portfolios across collective investment schemes that can cause a panic in the market.

2004 Observation: A Valuation Committee was established in 2002 to evaluate domestic securities and to develop a calculation methodology for pension asset management companies. The draft Investment Funds Act is envisioned to provide requirements for unified asset valuation.

Principles for market intermediaries

Principle 21: Regulation should provide for minimum entry standards for market intermediaries.

2000 Assessment: The principle was found to be largely observed.

2004 Observation: The SML provides most of the basic conditions for authorizing market intermediary business (e.g., competence, capital, recordkeeping, segregation of customer assets, conflicts of interest, best execution, etc.), licensee's preliminary requirements, and enforcement procedures. More specific requirements regarding internal control procedures to assure compliance with the laws and regulations also have been added. A licensee's preliminary requirements, including capitalization, stockholders' requirements, requirements for relevant certified specialists, prudential ratios, technical equipment, internal documents and structure requirements, relevant SRO are to be monitored constantly. Certain information provided in a licensing application has to be reported if it changes after the license is granted. There are also provisions for de-licensing, if changes occur that would disqualify the firm.

Principle 22: There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.

2000 Assessment: The principle was found to be largely observed.

2004 Observation: The initial minimum capital requirements and prudential ratios are imposed for market intermediaries, stock exchanges, the CSD, and OTC trading systems. The capital requirements and prudential ratios are the subject of permanent monitoring. Capital requirements include both on-balance sheet items and off-balance transactions for commercial banks and asset management companies, including pension assets management. For the rest of the licensees, off-balance sheet transactions are not included in a calculation of

capital adequacy. Prudential ratios include liquidity requirements, own investments, exposure to one issuer, and the like. Currently, professional intermediaries are subjects of supervision on consolidated basis. The implementation of consolidated supervision, however, can be further improved, which has been facilitated by integrated supervision, and is envisaged by the FSA. No changes in the reporting frequency have been instituted. In the future, a more risk-based approach may be considered.

Principle 23: Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

2000 Assessment: The principle was found to be non-observed. As noted under Principle 21 above, there were few clear requirements for internal control procedures to assure compliance with the laws and regulations. A code of conduct did not exist, although a KASE initiative on this was expected. There did not appear to be specific requirements of risk management capacity and procedures, aside from that of minimum excess capital.

2004 Observation: Professional intermediaries should have internal procedures and control order (Regulation and Internal Rules) approved by the FSA. All changes to the internal procedures and control order (Regulation and Internal Rules) of market intermediaries must be approved by the FSA. Licensing Rules include special requirements for technical and IT adequacy for each type of professional intermediary. The FSA is also responsible for formal attestation of specialists. Monitoring and inspecting procedures also involve control of qualification requirements, criteria of financial stability (prudential norms), and internal procedures compliance. Pursuant to the Broker/Dealer Activity Rules, the interest of the client is previous in case of conflict of interests, and the "best execution" method is imposed. All market intermediaries are required to: observe high standards of integrity and fair dealing, act with due care and diligence, act in a best interest of the client, disclose to the client where there is a potential conflict of interest, and treat all clients, in case of conflict of interest, the same. In order for banks to avoid conflicts of interest between its function as a broker/dealer and the interests of clients, which have entrusted their securities to the bank on the basis of a custody agreement, a "Chinese wall" has been set up. This structure means that all of a bank's departments engaged in custodial and broker/dealer activities should work separately and maintain confidentiality. In case of offenses by professional market participants, the FSA is empowered to impose penalties, recall approval of senior managers and reexamine certified specialists.

A Code of Conduct (Ethic Code) for Market Intermediaries and Qualified Specialists (this code is in the form of recommendations and does not have legislative power) was established at the Securities Market Experts Committee of the NBK in 2002. The Code determines standards of fair activity, confidentiality, and principles of fair competition. The Code of Conduct established by KASE is mandatory for broker-dealers that members of the KASE.

All market participants are obliged to enter into written contracts with clients. Typical contracts and orders have to be approved by the FSA. General requirements for contractual relations are determined by the Civil Code of Kazakhstan.

Independent registrars, depositories, and custodians have special technical requirements for keeping and updating information. Every customer of financial service has right to sue market intermediaries. Moreover, Financial Services Customer Protection Department of the FSA provides customer and investors with qualified consultation and informs relevant Inspecting Division.

While there are requirements for internal control procedures to assure compliance with the laws and regulations, as well as requirement of risk management capacity and procedures aside from the requirement to meet minimum excess capital, participants do not perceive any significant changes yet. Increasing awareness and understanding of these procedures through workshops and campaigns is required.

Principle 24: There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and contain systemic risk.

2000 Assessment: The principle was found to be non-observed. There did not seem to be any established procedures for dealing with the failure of a market intermediary or an insurance scheme to protect assets of investors dealing with a failed market intermediary.

2004 Observation: This principle is not directly regulated by effective legislation. Only withdrawal of the licensing procedure is established. In the case of bankruptcy, only the bankrupt institution's assets belong to creditor, except assets of clients. The following part relates to the self-assessment: "The FSA places information on the official sanctions made to the intermediaries on the website. Market intermediaries required to inform clients about own violation of prudential norms or financial stability criteria and sanctions of the FSA." The SML empowers the FSA to inspect and monitor liquidation and reorganization procedures of licensees; the FSA formed the Financial Organizations Liquidation Department to control the liquidation process. An insurance scheme to protect assets of investors dealing with a failed market intermediary does not yet exist.

Principles for the secondary market

Principle 25: The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.

2000 Assessment: The principle was found to be observed.

2004 Observation: Stock exchanges and OTC trading systems as licensees are subject to supervision, licensing, and prudential regulation. The FSA oversees the KASE and conducts close surveillance of the OTC trade system. The Regulations of the KASE (including operational rules, calculation methodologies, listing requirements, procedural rules, etc.) have to be approved by the FSA. The SML provides for authorization by the FSA

of a stock exchange as a noncommercial organization created by professional market participants. The SML directly provides for functions, membership, participants management, governance, income, transactions, obligations of listed issuers, market information dissemination, and liability and termination of an organized market. The SML also provides for authorization for operation of the OTC market. The concept of the OTC market reflected in the Act remains as it was in 2000.

Principle 26: There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.

2000 Assessment: The principle was found to be observed.

2004 Observation: The NBK has majority ownership of KASE and the FSA has authority to suspend securities trades. KASE's internal documents are subject to FSA approval. Stock exchange members have equal rights and responsibilities. Stock exchanges are required to form an internal control department. Trade systems, including OTC, are required to submit weekly, quarterly, and annual reports. The FSA also conducts close surveillance of the OTC market. Means to supervise trading systems include handling of error accounts, trade allocation of bunched or block orders, handling of unmatched trades, modification of orders entered into the system, technical standards, requirements for maintaining records and reporting failed trades, procedures related to operational failures, recordkeeping and retention, procedures for holding client funds and securities (financial integrity).

In practice, however, the illiquidity of the market and lack of order interaction makes market surveillance superfluous at the moment.

Principle 27: Regulation should promote transparency of trading.

2000 Assessment: The principle was found to be largely observed.

2004 Observation: This principle is observed in a sense that the regulation does try to promote transparency. However, the market is not transparent enough due to illiquidity and lack of order inter-action. For bonds, the existence of a five-minute window before orders are matched, allows some transparency of market prices. For shares, however, trades are still pre-arranged outside the exchange and only transacted on the exchange; and for those, the KASE remains a *de facto* information reporting center rather than an exchange.

The open trades' method is the basic method of trades on the stock exchange. The following methods of trades may also be applied: method of direct transactions, method of discrete trades (Frankfurt method of trades, Dutch method of trades, English method of trades, method of fixing). Algorithms of all applied methods of trades aim to achieve fair

trades on equal conditions for all participants. The methods of trades are subject to approval by the FSA.

The transactions with listed securities are required to be carried out through the CSD using delivery-versus-payment (DVP). The accounts under the transactions correspond to the recommendations of the “Group of 30,” i.e. the final settlement occurs not later than on the third working day from the date of the transactions.

The FSA expects the stock exchange to provide necessary and sufficient pre- and post-trade transparency to support reliable price information. Stock exchanges are expected to have arrangements that deliver this information on an equitable basis to all market members. Pre-trade information contains items of information on bids and offers for each transaction, both in the primary and the secondary market. Post-trade information contains information on the last sale price and on the volume of transactions. All stock exchange members have accesses to this information. The basic task of the stock exchange is to deliver pre- and post-trade information on an equitable basis to all market members.

Principle 28: Regulation should be designed to detect and deter manipulation and other unfair trading practices.

2000 Assessment: This principle was found to be materially non-observed. The Securities Market Law required organized and OTC markets as SROs, to establish a list of violations against which the markets would impose fines. However, the illiquid market and the nature of trading made detection of unfair trading practices difficult. In fact, the KASE did not have a market surveillance or stock watch system. The requirement to trade all open joint stock company shares through the KASE represented a step toward enhancing not only the liquidity of the KASE and the effectiveness of the price discovery but also market surveillance.

2004 Observation: The FSA has a new unit to detect speculation and manipulation, but it was established recently and is untested. The current illiquid market and the nature of trading demand continue to make detection of unfair trading practices difficult. The KASE still does not have a market surveillance or stock watch system. Current legislation prohibits market manipulation, market cornering, misleading statements, insider trading, front running, and other fraudulent or deceptive conduct, which may distort the price discovery system, distort prices, and unfairly disadvantage investors. Manipulation and other unfair trading practices are prohibited by civil legislation, criminal law, administrative law, and market rules of Kazakhstan. The Code of Conduct of market intermediaries and certified specialists provides for the basic types of unfair transactions. The establishment of standby mode in buy/sell share order satisfaction in the trading system of the KASE gives an opportunity to KASE to stop unfair securities transactions.

The order of recognition of the unfair transactions and price manipulation is currently being developed by the FSA and will be adopted in the first quarter of 2004. Theoretically, means to identify and address disorderly trading conditions (market surveillance) are

currently failing to: review for wash trading, review for price manipulation, review for congestion and cornering, review for unusual price or volume movement, and communication of price sensitive information to the market.

Principle 29: Regulation should aim to ensure the proper management of large exposure, default risk and market disruption.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: With the current illiquid market, trades are settled on a gross DVP basis. Hence, there are no counterparty credit risk exposures to manage. Accordingly, a settlement guarantee fund does not exist. OTC trades, however, are arranged bilaterally, and are possible to settle on a DVP basis. There is a transactions confirmation system, and information technology (IT) and software requirements were enhanced to avoid market disruption. As the market develops, additional systems will need to be put in place, and the solvency structure re-examined.

Principle 30: Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.

2000 Assessment: This principle was found to be largely observed.

2004 Observation: The FSA oversees the operation of the CDS. NBK Resolution no. 64 raised the minimal size of own capital for the CDS. As the market develops, monitoring may need to be increased and a greater sensitivity developed for potential vulnerabilities to systemic risk. The CDS effects gross DVP based settlement of securities trades and takes no settlement risk. The Bankruptcy Act reflects some impediments in effecting netting, for example, the pledge and liquidation of collateral.

B. Update Assessment of IAIS Insurance Principles

Summary of the 2000 FSAP assessment

29. The 2000 FSAP assessed Kazakhstan's observance of the IAIS Principles. Principles related to licensing, including fit and proper; capital adequacy; solvency; and confidentiality were fully observed. Kazakhstan was found to broadly observe requirements on technical provisions, financial reporting, on-site inspections, and sanctions. Kazakhstan was found to partially observe principles with respect to organization, assets, liabilities, and market conduct. Principles related to changes in control, corporate governance, and internal controls were not observed. Three principles were not relevant at the time (2.3, 9 and 15), and there was insufficient information to assess three other principles (7.3, 10, and 16). Compliance was expected to improve with the passage of new insurance legislation that would clarify the role of the supervisor regarding issuance of licenses; enforcement powers, particularly with

respect to ownership and transfer of control with insurance companies; as well as rules for corporate governance.

30. The 2000 FSAP recommended a radical reform of supervision capacity and practices. The insurance sector needed to modernize its accounting and auditing system in order to facilitate effective monitoring of the performance of insurance companies. Moreover, it was noted that the EU approach to solvency supervision demands new skills and a more qualified and professional staff of supervisors should be recruited and trained. It would be helpful to have training opportunities for supervisory personnel on such topics as accounting, reserving and new product opportunities. Company managers could also participate in this training.

31. On-site inspections tended to focus on compliance with the legal requirements. Sound practice would suggest examining how the company is managed, its business practices, its financial controls, and whether other important characteristics of a soundly operated institution are in place, such as how the company markets its products, and whether it has an explicit business strategy.

32. The principal recommendations made in the FSAP 2000 for the insurance sector were that Kazakhstan should: (i) pass new insurance legislation in line with modern international practices, (ii) prescribe and develop accounting principles and auditing and financial reporting, (iii) develop an actuarial profession, and (iv) upgrade supervision.

Summary of the 2004 update⁸

33. Since the 2000 FSAP, the authorities have made good progress in updating insurance legislation. The new legislation is well articulated, but is a bit too ambitious for the currently limited resources available to the Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Financial Organizations' (FSA's) Insurance Department and within the industry.

34. Implementation and enforcement practices need to be strengthened. The 2000 FSAP suggested development of an actuarial profession and an upgrade of supervision, but these recommendations have been difficult to carry out by the supervisory body and the insurance industry. However, the Society of Kazakhstani Actuaries, which was established in 2001–02, currently has 50 members, of whom 30 have an actuary license. It is unclear to what extent there is sufficient implementation capacity in the industry and the FSA to fully meet the legislative requirements. The FSA's enforcement track record is also limited, and given the recent changes in the regulatory organization, cannot be verified.

35. The FSA's insurance department is understaffed and has no formal training program. This limits the range and quality of the services it can render to the industry. The role of actuaries becomes ever more important as the industry grows to enable better measurements of risks and to establish a basis for pricing products. This may need to be reflected in the law.

⁸ The update of the IAIS Principles was prepared by Serap Gonulal (World Bank consultant).

At present, only four actuaries are available in the FSA to service both insurance and pension interests.

36. The FSA should work together with the associations and brokers to create relationships between insurers and policyholders and insurers and brokers. Among other things, the method for handling of claims and complaints would benefit.

37. The insurance industry should over time strive to raise its rate of insurance penetration as the economy grows. This would put Kazakhstan on a par with other Central and Eastern Europe markets. To achieve this objective, several major policy changes are needed. In particular, the industry should establish a reliable database to determine reserve requirements and tariffs for existing products, and, before introducing additional compulsory insurance products, it should ensure preconditions to determine appropriate reserve requirements and tariffs should be in place.

Update of IAIS principles

Principle 1: Organization

The insurance supervisory body of a jurisdiction must be organized so that it is able to accomplish its primary task, that is, to maintain efficient, fair, safe, and stable insurance markets for the benefit and protection of policyholders. It should be able at any time to carry out this task efficiently in accordance with the IAIS Principles. In particular:

- the supervisor should be operationally independent and accountable in the exercise of its functions and powers;
- the supervisor should have adequate powers, proper resources and staff, and the capacity to perform its functions, and exercise its powers;
- the supervisor should adopt clear, transparent, and consistent regulatory and supervisory processes;
- the decision-making lines of the supervisory body should be structured;
- the staff of the supervisor should observe the highest professional standards, including appropriate standards of confidentiality; and
- the supervisor should establish an employment system to hire, train, and maintain staff with the highest professional standards.

2000 Assessment: This principle was found to be partially observed. Updating existing legislation was deemed to be needed before the authority and powers of the supervisor could be rated completely satisfactory.

2004 Observation: At this juncture, obsolete legislation has been replaced producing the following changes:

The new law “On Insurance Activity,” which is currently in force, was adopted at end-2000. This law complies with international principles and standards of insurance

supervision. The law obtained a high degree of recognition by international experts and organizations. It gives sufficient powers to regulate the activity of all insurance and reinsurance companies, insurance brokers, and other professional participants of insurance market. In accordance with this law, more than 30 regulations were passed by the FSA. In addition, the Civil Code contains articles on insurance, the law on joint stock companies, and other laws regulate activities of insurance companies and other participants in the insurance market being legal entities.

On January 1, 2004, the FSA was established as a new independent financial supervision authority. Financial sector supervision, including of insurance companies and pension funds, was moved to the new agency from National Bank of the Republic of Kazakhstan (NBK). The FSA is accountable to the President of Republic of Kazakhstan. The FSA is funded by the NBK, and its budget is thus separate from the state budget. However, the FSA's budgetary autonomy should be ensured. All supervisors are covered by health and accident insurance bought for the employer's account. Currently, a staff of about 27 in the FSA, (about 10 in the on-site, 11 in the off-site, 4 in the actuary divisions), are designated to the supervision of the insurance sector. The Insurance Department has no formal training program. Due to the FSA's short supervisory history, it is premature to assess the supervisory and institutional capacity, the implementation and enforcement track record, and its governance.

Principle 2(1): Licensing

Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the supervisor:

- in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan, and projected solvency margins; and
- in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction, provided the prudential rules of the two jurisdictions are broadly equivalent.

2000 Assessment: The principle was found to be fully observed.

2004 Observation: No licenses were issued since the NBK became responsible for insurance supervision. In anticipation of the establishment of a new independent agency, it was necessary to establish, under the new legislation, licensing procedures. A special regulation has been passed, which contains requirements as to the documents and information required in the licensing procedure. The regulations regarding the review of license applications appear to be in compliance with this principle.

Principle 2(2): Licensing—Fit and Proper

2000 Assessment: This principle was found to be fully observed.

2004 Observation: Supervisors are expected to apply “fit and proper” tests to major shareholders and managers; to request a business plan; pro forma financials; and projections of solvency conditions.

Principle 2(3): Licensing—Reliance on other Jurisdictions

2000 Assessment: This principle was found to be not applicable.

2004 Observation: There is a special requirement in the new legislation that the founder of an insurance or reinsurance organization, who is a nonresident of the Republic of Kazakhstan, must submit a document from the appropriate insurance supervision agency of its own country. This document must confirm that the founder is permitted to participate in the charter capital of an insurance or reinsurance organization, which is a resident in Kazakhstan; or a statement indicating that no such permit is required under the legislation of the relevant country.

Principle 3: Changes of control

The insurance supervisor should review changes in control of companies that are licensed in its jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the requirements that apply when granting a license. In particular, the insurance supervisor should:

- require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and
- establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the owners, any new directors, and senior managers, as well as the soundness of any new business plan.

2000 Assessment: This principle was found to be not observed.

2004 Observation: Requirements concerning the transfer of blocks of shares of companies that would amount to a transfer of control are the same as those required for initial licensing of companies. Rules should be set by the supervisor, but enforcement would require the backing of legislation. There should be a formal notice of the intent to make such a transfer along with written criteria, which should be used to make the assessment of the appropriateness of the change. Such an authority is not currently provided by Kazakhstani legislation.

Currently, in order to acquire the right to control, possess, use, and dispose of more than 25 percent of the voting shares in an insurance or reinsurance organization, a shareholder must obtain the permission of the FSA. The procedures are determined by regulation issued by the FSA. Financial instability of the shareholder is ground for denial of a permission to acquire the right of control over an insurance or reinsurance organization. The FSA may require submission of founding documents, financial reports from founders, shareholders, and other legal entities having the control over an insurance or reinsurance organization. The FSA can also request necessary information from state agencies to the extent of their competence on matters related to the financial stability of such entities.

A person intending to acquire ownership or management of voting shares in an insurance or reinsurance organization of more than five percent of the total number of voting shares must notify FSA within 10 days after having purchased the shares. However, the rules on “changes in control“ are still incomplete.

Principle 4: Corporate governance

It is desirable that standards be established in the jurisdictions that deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the supervisor should set requirements with respect to:

- the roles and responsibilities of the board of directors;
- reliance on other supervisors for companies licensed in another jurisdiction; and
- the distinction between the standards to be met by companies incorporated in its jurisdiction, and branch operations of companies incorporated in another jurisdiction.

2000 Assessment: This principle was found to be not observed. At the time of 2000 FSAP, standards for corporate governance were not established.

2004 Observation: Legislative arrangements and standards for the requirements that govern the role and responsibilities of the board of directors of insurance companies, the system for internal control of the management as well as for internal audits have now been introduced.

In addition to the matters regarding competence of the board of directors, the legislation also require that the board of directors of an insurance or reinsurance organization shall be competent and able to consider matters related to violations of legislative requirements with regard to the financial stability and solvency of insurance and reinsurance organizations, based on the opinion of an authorized auditor, internal audit, or actuary.

An insurance or reinsurance transaction shall be deemed major, if the insured sum exceeds 25 percent of assets of the insurance company. Decisions to enter into major

transactions must be approved by the board of directors of the insurance or reinsurance organization based on a preliminary opinion of an actuary.

Principle 5: Internal controls

The insurance supervisor should be able to:

- review the internal controls that the board of directors and management approve and apply, as well as to require strengthening of these controls where necessary; and
- require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investments as well as liquidity management.

2000 Assessment: This principle was found to be not observed. Standards with regard to internal controls that the board and its management must apply, and to require strengthening where necessary, and the standards set by the board for underwriting risks and for setting qualitative and quantitative standards for investment and liquidity management did not exist.

2004 Observation: Improvements have been made in the legislation to regulate the internal audit requirements. However, there does not appear to be sufficient requirements for investment and liquidity management. There is a special regulation under preparation concerning conducting of internal audit procedures.

Principle 6: Prudential rules

The situation has not changed much since the 2000 FSAP. Consistent with the IAIS principles, the authorities maintain prudential standards designed to limit or manage the amount of risk that a company will undertake on a single exposure. All risk with a liability exceeding 10 percent of an insurer's assets must be reinsured. For small companies seeking to do business with clients that have very large exposures, such as petroleum companies in Kazakhstan, the consequence of the rule is that substantial elements of these policies must be reinsured with other companies, most of it with large international reinsurers not resident in Kazakhstan. This is an appropriate way to address risks involved in large exposures. The insurance rules also impose a condition that companies must retain at least five percent of the risk on any single policy for its own account. This rule is appropriate, as it seeks to ensure that insurance companies are legitimately engaged in assuming insurance liabilities and are not merely acting as brokers for their clients.

Prudential rules: assets

Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical

provisions, and should address the following: diversification by type; any limits or restrictions on the amount that may be held in financial instruments, property, and receivables; the basis for valuing assets, which are included in the financial reports; the safekeeping of assets; appropriate matching of assets and liabilities; and liquidity.

2000 Assessment: This principle was found to be partially observed. At the time of the FSAP, boards were not required to have investment policies, “per parcel” limits that would restrict the maximum exposure to any single counterparty, rules regarding the safekeeping of assets, or requirements that would deal with the appropriate matching of assets and liabilities.

2004 Observation: Currently, there is a special regulation that deals with the appropriate matching of assets and liabilities for the investment policy of insurance companies.

Principle 7: Liabilities

Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider the following:

- what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;
- the standards for establishing policy liabilities or technical provisions; and
- the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.

2000 Assessment: This principle was found to be partially observed. In 2000, there was uncertainty regarding the establishment of provisions for “unexpired risks”, technical reserves, and mathematical provisions.

2004 Observation: While provisions for unexpired risks still are uncertain, the other provisions have been established. To fulfill the commitments undertaken under current insurance and reinsurance contracts, an insurance or reinsurance organization must generate insurance reserves to the amount that is calculated by a licensed actuary.

The FSA has set additional rules to estimate insurance liabilities. For the non-life insurance business, they also include provisions for: unearned premium, claims incurred but not paid, and claims incurred but not reported. For the life insurance business, these include mathematical provisions and loss reserves. These are all required to be calculated mathematically according to actuarial principles and standards.

There are still no special rules or directives on how to calculate the provision for unexpired risks. Insurance companies, however, are obligated to set aside additional reserves in accordance to the actuarial report that is mandated to be produced twice a year.

The insurance reserves can be reduced by the amount of the reinsurer's recoverable, provided the reinsurer has a special credit rating from one of the assigned rating agencies. The share of the reinsurer's recoverable in insurance reserves is also required to be calculated mathematically following actuarial standards and practice.

Principle 8: Capital adequacy and solvency

The requirements regarding the capital to be maintained by companies which are licensed or seek a license in the jurisdiction, should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.

2000 Assessment: This principle was found to be fully observed.

2004 Observation: Efforts have been made by the authorities to introduce EU standards in national legislation. The capital requirements in the new law are based on the approach of the EU directives on solvency. Minimum capital depends on the value of the business or classes of insurance. For newly established companies the minimum capital is as follows:

Non-life insurance companies	T 130 million + classes 1/
Life insurance companies	T 150 million + classes 1/
Reinsurance companies	T 230 million

1/ Additional requirements for the classes vary from T 5–20 million for each class.

There are 4 classes in life insurance and 16 classes in non-life insurance.

Active insurance companies have the following capital requirements. For non-life insurance companies, there are three types of calculations affecting the minimum capital requirement:

- 1) T 100 million + classes;
- 2) T 100 million + 16 percent of insurance premiums for the last financial year multiplied on the ratio;
- 3) T 100 million + 23 percent of burden of claims for the last financial year multiplied on the ratio.

The ratio is, based on the last financial year, the difference between the amount of claims remaining to be borne after deduction of transfers for reinsurance and the gross amount of claims, which may in no case be less than 0.5.

For life insurance companies, there are two types of calculations, and the highest result stipulates the minimum capital requirement:

- 1) T 130 million + classes;
- 2) T 130 million + 4 percent of insurance reserves.

Principle 9: Derivates and off-balance sheet items

This section applies in jurisdictions, where derivatives or other items are not reported on the balance sheet and thus are not subject to the reporting requirements established for financial statements.

The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form a part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address:

- restrictions in the use of derivatives and other off-balance sheet items;
- disclosure requirements for derivatives and other off-balance sheet items; and
- the establishment of adequate internal controls and monitoring of derivative positions.

2000 Assessment: This principle was found not to be applicable at the time.

2004 Observation: The new legislation has made this principle relevant. According to current legislation, the financial reports should contain information on derivatives and off-balance sheet items (i.e., SWAPs, forwards, futures), information on guarantees, conditional liabilities, the property including machinery that giving rent, debts that are accounted as loss, etc., in accordance with international standards.

Principle 10: Reinsurance

This section applies in jurisdictions, where reinsurance companies are not subject to the same supervisory rules as insurance companies. Insurance companies use reinsurance as a means of risk containment. The supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements, and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.

The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies which address:

- the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer; and
- the amount of reliance placed on the insurance supervisor of the reinsurance business of a company.

2000 Assessment: This principle was not assessed due to lack of information. The supervisor needs to be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. The 2000 FSAP team was told that companies provide information to the supervisor on their reinsurance arrangements. However, the frequency of this reporting and the manner in which this information is collected and processed by the supervisor was not clear at the time of FSAP.

2004 Observation: According to current legislation, an insurance or reinsurance organization in Kazakhstan can transfer the insurance risks it has undertaken for reinsurance outside Kazakhstan with a reinsurance organization that is not a Kazakhstan resident, directly, through a resident insurance broker, or nonresident broker, provided that these reinsurance organizations and insurance brokers have a specified rating. The list of rating agencies and the minimum rating is currently being prepared by the FSA.

At present, there is a special regulation regarding Kazakhstani insurance brokers' activity, including requirements for the reinsurance cover and responsibility of the brokers.

Principle 11: Market conduct

Supervisors must ensure that insurers and intermediaries exercise the necessary knowledge, skills, and integrity in dealings with their customers. Insurers, intermediaries, and customers must disclose relevant information to each other with a view to ensure fair contractual and other treatment; conflicts of interest must be avoided. In particular, supervisors:

- require insurers and intermediaries to have clearly stated policies in place on how to treat customers fairly;
- must regularly monitor compliance with the stated market conduct policies of insurers and intermediaries;
- must set policy and guidelines with regard to compulsory disclosure to the customer of relevant, meaningful, and understandable information regarding the insurer, intermediary, product, risks, benefits, obligations, charges, and estimated returns;
- require insurers and intermediaries to seek information from their customers, which might reasonably be expected, before giving advice or concluding a contract;
- require insurers and intermediaries to have internal rules in place to avoid conflicts of interest, and how to ensure fair treatment of customers if conflicts arise; and
- require insurers and intermediaries to deal with customer complaints effectively and fairly through a simple and equitable process. This process should be well disclosed and easily accessible.

2000 Assessment: This principle was found to be partially observed. Market conduct supervision in Kazakhstan was limited to monitoring the application of tariffs for motor vehicle insurance and publication of rules concerning other forms of mandatory insurance.

2004 Observation: Insurance companies are required to submit for approval by the FSA, rules concerning conditions for each type of insurance they conduct. The insurance company should carry out its activity in strict accordance with the approved rules. The rules should also contain information on tariffs and calculation of the tariffs. There is a special FSA division dealing with complaints of customers. If the customer feels that the insurance company violates the legislation or other regulations, the customer can send a written complaint about the insurance company, insurance broker, and the like to the FSA. The FSA is required to follow up on all such complaints.

Principle 12: Financial reporting

It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis. A process should be established for:

- setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports, and other relevant information;
- setting the accounting requirements for the preparation of financial reports in the jurisdiction;
- ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and
- setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.

In doing so, a distinction may be made:

- between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and
- between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in other jurisdictions.

2000 Assessment: This principle was found to be broadly observed. At the time, a project was under way to develop new accounting standards for insurance companies. The

resulting standards were to be prescribed for use in all financial statements prepared in respect of the business of supervised insurance companies. Furthermore, the accounting and auditing profession in the country were not familiar with insurance business and its special accounting characteristics.

2004 Observation: Currently, two regulations address the financial reporting of insurance and reinsurance companies as well as insurance brokers:

- one includes instructions regarding forms and terms of financial reporting of insurance and reinsurance companies as well as insurance brokers. This regulation was passed in order to further the development of accounting practice and provides transmission of international standards on financial reporting. The document was developed in accordance with international accounting practices.
- another deals with specifications for the accounting of assets, liabilities, equity, income, expenses, and similar issues for insurance and reinsurance companies in accordance with international practice of insurance accounting.

A financial report observing this regulation is required to be submitted on a monthly and quarterly basis to the FSA. The regulations also cover the procedures, forms, and terms of annual financial reports of insurance and reinsurance companies. They specify how annual reporting and external audit procedures of annual financial report should be carried out.

Principle 13: Onsite inspection and access to information

The insurance supervisor should be able to:

- carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and
- request and receive any information from companies licensed in its jurisdiction, whether this information is specific to a company or requested of all companies.

2000 Assessment: This principle was found to be broadly observed. On-site inspection was a relatively new activity at the time of the 2000 FSAP.

2004 Observation: The FSA has established internal rules and directives in order to carry out on-site inspections. They describe in detail the subject of inspections and focus on areas of highest risk to the insurance company, such as solvency, capital adequacy, insurance reserves, and unexpired risks. Inspectors have the right to request from the insurance company any additional internal documents, such as books, records, all accounts, etc. during an inspection. These rights give inspectors the opportunity to see the entire picture, including

the solvency of the insurance company. Both on-site and off-site reports are used in the analysis of the company.

Principle 14: Sanctions

Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the supervisor and may include:

- the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;
- the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and
- the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the license of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.

2000 Assessment: This principle was found to be broadly observed. The legislation in effect in 2000 provided sufficient powers to the supervisor to impose sanctions on companies that failed to meet the requirements.

2004 Observation: The new legislation has been further developed, and it provides for enhanced and adequate powers, which enable the FSA to apply a broad range of sanctions to solve the problems as soon as detected.

Principle 15: Cross-border business

Insurance supervisors should apply the following principles to the supervision of cross-border business operations:

- no foreign insurance establishments should escape supervision;
- all insurance establishments of international insurance groups and international insurers should be subject to effective supervision;
- the creation of a cross-border insurance establishment should be subject to consultation between host and home supervisors; and
- foreign insurers providing insurance cover on a cross-border services basis should be subject to effective supervision.

2000 Assessment: This principle was found not to be applicable.

2004 Observation: According to current legislation, insurance companies with foreign capital participation—partial or full—are also subject to regulation and supervision. In order to establish an insurance business in Kazakhstan, foreign insurers must establish an insurance company in Kazakhstan or buy an existing insurance company. International insurance groups and international insurers planning to create an insurance company in Kazakhstan must get an approval from their local supervision agency and provide a copy to the FSA.

Principle 16: Coordination and cooperation

In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained. In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:

- is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e., insurance, banking or securities) to share information or otherwise work together;
- is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors, who have agreed, and are legally able, to treat the information as confidential;
- should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and
- is permitted to set out the types of information, as well as the basis on which information obtained by the supervisor may be shared.

2000 Assessment: This principle was not assessed due to lack of information.

2004 Observation: There was no opportunity to assess the extent to which the insurance supervisors in Kazakhstan liaise with supervisors in other jurisdictions. The FSA, and previously the NBK, has been a member of IAIS since 2000. On-site inspectors and other specialists according to their responsibilities and current jobs cooperate with supervisory authorities of other countries, which also are members of IAIS through letters and requests. Legislation regarding money laundering and combating financing of terrorism is currently being prepared.

Principle 17: Confidentiality

All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections. The insurance supervisor is required to hold confidential any

information received from other supervisors, except where constrained by law or in situations where the supervisor, who provided the information, provides authorization for its release.

Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another supervisor cannot be kept confidential, are urged to review their requirement.

2000 Assessment: This principle was found to be fully observed.

2004 Observation: FSA employees are required to keep confidential any information they receive in the course of their activities, including on-site inspections. There are a few common laws on confidentiality of civil servants that should be maintained by the staff of the FSA. A special chapter in the Civil Code on “insurance secrecy” also determines the responsibility of FSA staff concerning unauthorized disclosure of information. Financial and other reports of insurance companies that submitted electronically to the FSA are encoded.

C. Update: Core Principles for Systemically Important Payment Systems

38. The 2000 FSAP assessment of the observance of the *Core Principles for Systemically Important Payment Systems* found many principles observed or broadly observed, but also identified important weaknesses.⁹ In 2000, both the system for large-value and time sensitive interbank payments (SLP) and the system of retail payments (SRP)—a multilateral netting system for small electronic retail payments—were considered systemically important. Weaknesses mainly related to the SRP. There were insufficient assurances of timely settlement and protection against systemic risk, in the event of the inability of the largest debtor to settle at the end of the day. There were also concerns regarding appropriate incentives to manage and contain risk in case of an unwind of the SRP. However, the participants were reportedly made aware of the consequences of an unwind. Moreover, there were serious concerns regarding the fact that the SLP and the SRP used the same computer without a hot back-up, which was being built at the time. Furthermore, there were concerns regarding real-time finality being consistent with the bankruptcy law (zero-hour rule). The assessment was done before the assessment methodology was adopted.¹⁰

39. Since the 2000 FSAP, the NBK, in collaboration with the Kazakhstan Interbank Settlement Center (KISC), has continued reforming the payment systems.¹¹ At end-2000, the

⁹ The assessment was done by Tonny Lybek (MFD, IMF) and Tomáš Hládek (Czech National Bank).

¹⁰ The *Guidance Note for Assessing Observance of Core Principles for Systemically Important Payment Systems (CPSIPS) and The Structure and Scope of the Assessment Report* was issued by the International Monetary Fund and the World Bank, in collaboration with the Committee on Payment and Settlement Systems, in August 2001.

¹¹ For an overview of the payment systems and securities settlement systems in Kazakhstan, see *Payments Systems in Kazakhstan* prepared by the National Bank of Kazakhstan and the Committee on Payment and

(continued...)

SLP became the *Interbank System of Money Transfer* (ISMT). Cash and credit transfers remain the most dominant methods of payments, although the use of direct debits is growing. Payment cards remain in early stages of development, but their use has grown rapidly during 2003. The payment leg of securities transactions traded at the Kazakhstan Stock Exchange (KASE) is settled through the ISMT on settlement day.¹² The securities leg is settled via the Central Securities Depository (CSD) delivery-versus-payment (DVP) on a trade by trade basis (NBK securities and government bonds are T+0 and other securities are T+3). The local currency leg of foreign exchange transactions is settled through correspondent accounts with KASE at the NBK and the foreign currency leg is settled through foreign correspondent banks. A law on digital signatures has been adopted.

40. In 2003, a new assessment was done, but only of the ISMT, which was considered systemically important.¹³ All principles were observed, with the exception of core principle 1. The assessor had concerns regarding consistency between the Act on Payments and Money Transfers and the Bankruptcy Law regarding real-time finality (zero-hour rule); while the authorities maintained that the legal arrangements did not allow any discussions of irrevocability. The assessor recommended that a clause be added in the Bankruptcy Act to strengthen the legal support of irrevocability of payments, which have been settled in good faith (the payee's bank or the payment system provider do not have any knowledge of any bankruptcy procedure) even after the moment the court declares an entity bankrupt.

41. Since the 2003 assessment, concerns regarding security of the payment system have emerged but have been promptly addressed. The Payment System Department of the NBK found it necessary to conduct on-site inspections to verify that procedures allowing only authorized access to terminals and passwords are in place and followed. Moreover the establishment of the FSA has changed the procedure for licensing of payment service providers. An applicant must now approach the FSA, which subsequently asks the NBK to review and consider the application. The NBK then makes recommendations to the FSA, which informs the applicant. Furthermore, legal clarification of the irrevocability in the bankruptcy law has not yet been introduced. Members of the ISMT not following appropriate security procedures should be subject to severe sanctions. To ensure the integrity of the system, breaches could necessitate that a member be denied access to system until appropriate controls are in place.

Settlement Systems of the central banks of the Group of Ten countries, November 2003. This methodology requires that to the other core principles are observed to observe core principle 10 on effective, transparent and accountable governance of the payment system.

¹² The *Recommendations for Securities Settlement Systems*, issued by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) in November 2001, were not assessed.

¹³ The new assessment was performed by Tomáš Hládek (Czech National Bank).

D. Update: Code of Good Practices on Transparency in Monetary and Financial Policies

Update on transparency in monetary policy

42. The 2000 FSAP report on monetary and financial transparency concluded that the National Bank of Kazakhstan (NBK) was relatively transparent in its conduct of monetary policies. At the same time, the report emphasized that some areas required improvements, particularly with respect to central banks governance and internal audit. Specifically, the assessors concluded that the law on central bank should list general criteria for the removal of the heads and members of the governing body of the central bank. Also, the information on the structure and functions of the central bank's policy making body was not available to the public. The assessors stressed that disclosed financial statements lacked information on auditing policies and did not provide the public with qualifications. In addition, the documents on internal auditing and practices of internal audit division were not publicly disclosed.

Description of progress and recent developments

43. The NBK has maintained high standards of transparency. Kazakhstan successfully completed subscription to the SDDS in March 2003. The NBK's website (<http://www.nationalbank.kz>) has been improved. The central bank has been more open about its monetary policy targets by issuing public statements and using mass media. In 2002, the NBK announced its plans to move to inflation targeting framework by 2006.

44. Other areas of changes are the following:

- The information on the terms of refinance and other central bank facilities disclosed are now published in the "Bulletin of the National Bank." However, the aggregate amounts of central bank monetary policy facilities are not available to the public.
- The schedule on the meetings of the main policy-making body, the Supervisory Board, is published in the Bulletin along with the Board's working-plan.
- The Presidential Decree on the Central Bank Statue and Structure from December 31, 2003 explicitly prohibits direct lending to the government.
- As a subscriber to the SDDS, the NBK has started publishing data on the template on international reserves and foreign currency liquidity. Since 2003, the basic principles for the NBK reserve management investment strategy are described and published in the Investment Strategy Managing Foreign Exchange Reserves of the National Bank of Kazakhstan.
- The NBK has adopted and published regulations describing rules and procedures for the central bank's relationships and transactions with counterparties in its monetary operations and in the markets where it operates.

- The NBK has published its expenses on funding its auxiliary operations, including the Kazakhstan Interbank Settlement System, Kazakhstan Mint, etc.

45. However, while a number of amendments to the existing Law on the National Bank were introduced between 2000 and 2003, there have been limited changes in areas of governance, accounting, and internal auditing. The laws do not spell out the general criteria for removal of the heads and members of the governing body of the central bank, for example. Accounting policies and internal governance procedures are not publicly available and are not included in released financial statements. While the NBK provides some information on internal audit in its annual report, the disclosed section contains only limited information.

Update of transparency in financial policies

46. The 2000 FSAP report on transparency in financial policies concluded that the NBK had significantly improved its transparency practices. It was mentioned that the NBK used essentially identical vehicles for achieving transparency both in monetary and financial policies. There were only few areas where disclosure standards were not fully observed. In addition, some coordination problems between two financial supervision agencies were noted.

Description of progress and recent developments

47. In January 1, 2004, a new independent Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Markets and Financial Organizations (FSA) was created. The FSA was established by the Law on Government Regulation and Supervision of the Financial Market and Financial Organization and is regulated by the President's Decree on Further Improvement of the Government Administration System. The FSA is responsible for banking, insurance, securities market, and pension funds supervision, and is directly subordinated to the President of the Republic of Kazakhstan. The Board of the FSA, consisting of members from the NBK, Ministry of Finance, the President's Office, and the FSA Chairman, is the decision-making body. The NBK remains responsible for regulating and supervising the payments systems.

48. The new agency is founded on the former financial supervision unit of the NBK. The new institution has kept most of the staff from the NBK. Moreover, it remains financially dependent on the NBK and is sharing some of the administrative functions with the central bank.

49. The authorities maintain that the guiding principles of the new institution will remain unchanged from those practiced by the financial supervisory unit under the auspices of the central bank. Arguably, there will be no changes in financial institutions' reporting requirements and regulations of organized financial markets, as well as in reporting requirements. Public disclosure procedures for aggregated financial sector data have also

remained unchanged. To date, public information on financial sector issues is mainly published on the NBK's website and publications.

50. However, some important gaps remain within the new institutional setup. The law on the FSA provides fewer provisions for disclosure than the law on the central bank. For example, unlike the law on central bank, the new law does not establish any modalities of accountability and does not make public the list of FSA publications. Also, the law does not require the submission of the annual reports to the President of the Republic of Kazakhstan. The FSA has yet to establish its public information service and publication program and the availability of its senior officials to explain their institution's objectives and performance to the public has to be tested (there is no requirement in the regulations).

51. The FSA is not required to publish audited financial statements or its operating expenses. Since the FSA is fully financed by the central bank, the NBK has to disclose its expenses related to financial supervision. In addition, there are no internal audit function established so far—nor has it been required by regulations—and the internal procedures have yet to be established. The new law on the financial supervisory agency does not disclose the criteria for removal of the heads and members of the governing body of supervisory agency, although Article 26 of the Law on Civil Service does note misdeeds shall be ground for dismissal.

52. The FSA law outlines the areas of interaction with the NBK, and an agreement on cooperation has been signed, including some provisions regarding information sharing and consultation between the NBK and the FSA. The Law on the NBK does not refer to the FSA, while assigning some supervisory functions to the NBK, although the division of those functions is not explicit clear.

III. ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

A. General

Information and methodology used for the assessment

53. A detailed assessment of Kazakhstan's compliance with the international standards on anti-money laundering (AML) and combating the financing of terrorism (CFT) was prepared by a team of assessors that included staff of the International Monetary Fund (IMF), the World Bank (WB), and an independent law enforcement expert.¹⁴ As stipulated by the methodology, the latter was not under the supervision of IMF and WB staff, but he was selected from a roster of experts on criminal law enforcement and on non-prudentially regulated activities. IMF and WB staff reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering (ML) and financing of terrorism (FT) among regulated financial institutions. The law enforcement expert, who is not under the supervision of IMF and WB staff, reviewed the capacity and implementation of criminal law enforcement systems. *The law enforcement expert's assessment and comments are in italics.*

54. The assessment team experienced good collaboration. The team met with representatives of the following agencies: the Ministry of Justice, the General Prosecutor's Office, the Ministry of Finance, the Agency for the Fight Against Economic and Corruption Crimes, the Ministry of Interior, the Kazakhstan's National Security Committee (KNB), the Customs Department, the Regulation and Supervision Agency of the Financial Market and Financial Institutions (FSA), the National Bank of Kazakhstan (NBK), the Association of Financiers, and the Central Securities Depository (CSD). In addition, the team met in Almaty with representatives of commercial banks, local securities broker/dealer, and external auditors.

General situation of money laundering and financing of terrorism

55. Reputational risk remains a potential concern for financial sector stability and the authorities' development plans. For instance, some banks rely on foreign funding. Kazakhstan's economic recent growth is largely based on substantial oil, gas and mineral reserves; and was facilitated by early reforms, such as its rapid privatization in the 1990s. Its geographic location, however, renders it a potentially convenient drug trafficking corridor.¹⁵ The authorities indicated that they have arrested persons for drug trafficking who may have been using the proceeds to fund terrorism. These factors, together with organized crime, regional security issues, lack of transparency linked to natural resource management,

¹⁴ The AML/CFT assessment team comprised: Joy K. Smallwood (Legal Department, IMF), Cari Votava (Senior Financial Specialist, World Bank), and Evgeniy Volovik (Russian Department of Financial Monitoring, KFM), as the independent AML/CFT law enforcement expert.

¹⁵ See *Money Laundering and Related Issues in Kazakhstan*, GPML, Central Asia Briefing, UN Office for Drug Control and Crime Prevention, May 2002.

particularly the energy and mineral sector, and the need to encourage foreign investment create substantial challenges in respect of limiting risks related to money laundering and terrorist financing. Because the links between drug trafficking and terrorism in the region could present serious challenges to regional and economic stability, lack of attention to implementing appropriate AML/CFT policies, procedures and sanctions could handicap Kazakhstan's development efforts.

Overview of measures to prevent money laundering and the financing of terrorism

56. Kazakhstan has signed international conventions that are directly relevant for AML/CFT legislation, with the exception of the Palermo and the Strasbourg Conventions. The Vienna Convention has been signed and ratified although it has not been fully implemented. The UN Security Council Resolutions relating to the financing of terrorism have not been implemented by Kazakhstan, although the various lists have been forwarded by the government to the relevant competent authorities and also circulated to various ministries for review and investigation. The private sector is complying with the process on a voluntary basis. To date, no names have matched names on the UN lists.

57. The existing legislative framework recognizes ML and FT, but does not observe the international standards. The Criminal Code recognizes money laundering as a financial crime; however, its legal definition does not yet meet recognized international conventions and standards.¹⁶ A financial intelligence unit (FIU) does not exist. The provisions in the banking law on bank secrecy law subjects anyone to criminal sanctions who discloses suspicious transaction data even to authorized bodies. Only the Prosecutor's Office has the authority to pierce the bank secrecy provisions when investigating a criminal matter. Financing of terrorism has been added to the definition of Terrorist Activity in the *Law of the Republic of Kazakhstan of July 13, 1999 No. 416-1 on Combating Terrorism (with changes introduced by the Law of the Republic of Kazakhstan as of February 19, 2002 No 295-II)*. However, financing of terrorism has been not been criminalized as a separate offense from terrorism in the Criminal Code. Therefore, while terrorism is a predicate offense for money laundering, financing of terrorism is not. Although this will allow the authorities to pursue the financing of terrorism in some limited circumstances as part of terrorist activity, it does not fully satisfy the requirements on combating financing of terrorism and international cooperation as set out in the International Convention on the Suppression of the Financing of Terrorism (ICSFT).

58. The authorities recognize the existing legal framework is insufficient in the current environment and have initiated measures. Kazakhstan remains a relatively cash-based economy, which impedes the ability of enforcement authorities to pursue investigations and convict criminals for organized crime, money laundering, and terrorist financing.

¹⁶ United Nations Conventions on Money Laundering and Terrorist Financing (Vienna 1988, Palermo 2000, Suppression of Terrorist Financing 2000, and Security Council Resolution 1373) and the FATF 40 + 8 Recommendations.

Furthermore, controls on precious metals, including those of strategic significance, do not currently exist, although there are plans to regulate the metals market. Officials also recognize that there exists a significant unregulated economy in Kazakhstan, which thrives outside the formal financial sector, although that may be more related to tax evasion than ML and FT. Government officials from various enforcement and financial sector regulatory agencies have participated in AML/CFT training programs over the past year, which indicates emerging political will to build a legal framework to combat money laundering and terrorist financing.

59. Kazakhstan has continued its efforts to improve and consolidate its financial sector supervisory capacity by the establishment of a newly created *Agency on Regulation and Surveillance of Financial Markets and Organizations* (FSA), which is responsible for regulating and licensing of banks, insurance companies, capital markets, and other financial sector entities. As the FSA started its operations January 1, 2004, it has yet to fully establish its surveillance and supervisory activities, though admittedly it is carrying on the tasks that were previously with the NBK.

60. The drafting of a new comprehensive AML/CFT law, which will meet international standards, has begun and been tasked to the Agency for the Fight Against Economic and Corruption Crimes.¹⁷ Other legislation will have to be amended accordingly, including: the Criminal Code, the Criminal Procedure Code, Banking Law, Insurance Laws, Securities Laws, and laws governing other commercial entities, Financial Sector Supervisory legislation, the Law on the Prosecutor's Office (1995), provisions relating to mutual legal assistance and cooperation in the Criminal Procedures Act. Due to the lack of a comprehensive AML/CFT law, the legal tools and mechanisms for officials to prevent and deter money laundering and terrorist financing activities are limited.

B. Detailed Assessment

61. The following detailed assessment was conducted using the October 11, 2002 version of the *Methodology for Assessing Compliance with the AML/CFT International Standards, i.e., the criteria issued by the Financial Action Task Force (FATF) 40+8 Recommendations* ("the Methodology").

¹⁷ It is anticipated that the law will be sent to the Kazakhstani Government for consideration and adopted by the Parliament before end 2004.

Assessing criminal justice measures and international cooperation

Table 3. Detailed Assessment of Criminal Justice Measures and International Cooperation¹⁸

<i>I—Criminalization of ML and FT</i> (compliance with criteria 1-6)
Description
<p>Conventions (Criterion 1)</p> <p>Kazakhstan is a party to the United Nations Convention on Illicit Drugs and Psychotropic Substances (Vienna Convention) which entered into force in 1990. Kazakhstan ratified the Vienna Convention on June 28, 1998 in the Law of Kazakhstan 240-1. It appears that the Vienna Convention has not been fully implemented in the law of Kazakhstan.</p> <p>Kazakhstan is not yet a party to the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (Strasbourg Convention), but intends to sign and ratify the Strasbourg Convention although no specific timetable is in place for such actions.</p> <p>Kazakhstan has signed the UN International Convention for the Suppression of the Financing of Terrorism (ICSFT) with accession to the ICSFT taking place in February 2003. ICSFT provisions on the financing of terrorism are not yet fully implemented in the law of Kazakhstan.</p> <p>Kazakhstan has not yet ratified the Palermo Convention, which was signed in December 2000 but intends to ratify and implement the Palermo Convention, although no specific timetable is in place for such actions. Generally, the authorities indicate that substantive changes in domestic law necessary to implement various conventions are currently being discussed and various draft laws are being circulated between ministries. While many authorities are hopeful that the required laws and procedures necessary for ratification and implementation of all conventions will occur in 2004, there is no concrete timetable or action plan for such actions.</p> <p>Kazakhstan has not fully implemented the United Nations Security Council Resolutions (SCRs) 1267, 1269, 1333, 1373, and 1390 although both relevant competent authorities and financial institutions are voluntarily complying with the UN Resolutions. Regarding UN Resolutions 1267, 1390, and 1373 specifically: While Kazakhstan has circulated the UN lists on the freezing of all funds and economic resources belonging to, or owned or held by, a natural or legal person, group or entity designated by the Sanctions Committee, a judge from Kazakhstan must review the case and pronounce that this natural or legal person is a terrorist, as detailed by the laws of Kazakhstan. While all natural or legal persons, entities and bodies within the country are requested to provide information that would facilitate compliance with the law/regulations to designated national authorities, in this case the National Security Committee, these provisions are currently not mandatory but only voluntary. Thus, provision of such information could result in criminal liability for violation of bank secrecy provisions. Furthermore, there is currently no designated institution that collects and provides information on frozen assets. There is also no effective mechanism for freezing funds. Funds may only be frozen by the General Prosecutor’s Office (“PO”) when investigating a criminal case. There are no effective administrative mechanisms for freezing funds or seizing property.</p> <p>Criminalization of Money Laundering (2, 5)</p> <p>Kazakhstan has criminalized money laundering in Article 193 of the Criminal Code, but the definition of money laundering is not in full compliance with international standards. Article 193 sanctions the laundering of monetary resources or other property acquired illegally. Article 193 states that:</p>

¹⁸ *The text in italics has been prepared by the independent law enforcement expert.*

“(1) the commission of financial operations and other transactions with monetary resources or other property knowingly acquired illegally or, similarly, the use of the aforementioned resources or other property for the performance of entrepreneurial or other economic activity shall be punishable by a fine in the amount of 500 to 700 monthly reference indicators or in the amount of the wages or other income of the guilty party for a period of five to seven months, or detention for a period of up to six months, or imprisonment for a period of up to three years with a fine in the amount of up to 100 monthly reference indicators or in the amount of the wages or other income of the guilty party for a period of up to two months or without such.

(2) the same act committed:

a) by a group of persons with advance collusion;
b) more than once;
c) by a person using his official position –
shall be punishable by imprisonment for a period of two to five years with confiscation of property or without such.

(3) The actions stipulated in the first or second parts of this article committed:

a) by a person authorized to perform state functions or an equivalent person, if they are attended by the use of his official position;
b) by an organized group
c) by a criminal society (a criminal organization) or in large amounts

shall be punishable by imprisonment for a period of three to seven years with loss of the right to occupy certain posts or engage in certain activities for a period up to three years, and in instances stipulate by item a) – up to seven years with confiscation of property or without such.

Remarks.

1. In this article a “large amount” shall be deemed the commission of a transaction or use of monetary resources or other property in an amount exceeding 10,000 monthly reference indicators.

2. A person voluntarily declaring a laundering of monetary resources or property acquired illegally that is in preparation or has already been committed shall be exempted from criminal liability if his actions do not contain the formal elements of the crimes stipulated in the second and third parts of this article or another crime.”

Longer sentences are provided for groups of persons with advance collusion, repeat offenders or multiple offenses, persons using their official position, organized groups, criminal societies or organizations, or laundering of large amounts of money or property (over 10,000 monthly reference indicators.) Currently, a monthly reference indicator is valued at T 919 (approximately US\$6).

The mission was advised that all crimes which generate funds may be considered predicate offenses in Kazakhstan. The most commonly used predicate offenses for ML offenses are Article 192 on pseudo entrepreneurship, which is the establishment of commercial organizations without an intent to act as an entrepreneur or conduct banking, aiming to get loans, tax evasion, derivation of other property benefit, or illegal activity that caused large economic damage; Article 190 on false business or entrepreneurship; Article 222 on tax evasion; Article 213 (failure to return from abroad means denominated in foreign currency); Article 233 (terrorism); Article 233-1 (terrorism propaganda or public calls to perpetrate terrorism), Article 233-2 (establishment and leadership of a terrorist group and participation in its activity) of the Criminal Code of Republic of Kazakhstan. Other predicate offenses include crimes which generate proceeds illegally. No specific definition of such crimes is provided.

Persons may be convicted of both ML and a predicate offense. If no conviction of the predicate offense, there may be a possibly for conviction for money laundering if there is a case that “illegal proceeds” were generated.

There is currently such a case being prosecuted before the courts, but at this point there have not yet been any cases decided on. In the vast majority of cases, however, a link between the ML and a specific predicate offense is proved as most cases involving money laundering involve tax fraud related crimes. The authorities have not expanded money laundering investigations beyond this narrow class of cases in practice.

The offense of money laundering extends to property that directly or indirectly represents the proceeds of crime and extends to any type or property. The Criminal Procedure Code sets out the definition of “property” and that definition is broad enough to cover all of the above. See further discussion of this under “Provisional Measures, Criterion 7.

The authorities indicated that conduct that occurs in another jurisdiction may constitute a predicate offense only if there is a conviction for this crime in the other jurisdiction, although there is no explicit provision in either the Criminal Code or the Criminal Procedures Code in Kazakhstan. A foreign conviction will be required even if the activity is a crime in Kazakhstan. Where the underlying conduct is punishable in Kazakhstan, but not in the jurisdiction where the conduct occurred, the Prosecutor General’s Office (PO) would not take a ML prosecution. In order to consider a prosecution for ML, the PO would need a case file to be transferred from abroad. The PO would then review the case and decide whether or not to proceed. There have been no cases addressing these matters.

Article 193 notes that “a person voluntarily declaring a laundering of monetary resources or property acquired illegally that is in preparation or has already been committed shall be exempted from criminal liability if his actions do not contain the formal elements of the crimes stipulated in the second and third parts of this article or another crime.” Such provisions have been introduced in response to EU requests for softening of some of the harsher provisions of the laws in Kazakhstan.

Criminalization of FT (3, 5)

Kazakhstan has not fully implemented the International Convention for the Suppression of the Financing of Terrorism (ICSFT). There is no Criminal Code provision on financing of Terrorism although Terrorism has been criminalized in Articles 233, 233-1, and 233-2 of the Criminal Code. The financing of terrorism has been added to the definition of Terrorist Activity in the Law of the Republic of Kazakhstan of July 13, 1999 No. 416-1 on Combating Terrorism (with changes introduced by the Law of the Republic of Kazakhstan as of February 19, 2002 No 295-II) but Articles 20 and 21 of the above captioned law state that “persons participating in terrorist activity should bear the criminal responsibility as provided in the legislation of Kazakhstan” and that terrorist activity should be “suspended on the territory of Kazakhstan.” This is not enough to satisfy the requirements of the ICSFT. Further, the PO advised that the Criminal Code of Kazakhstan is separate and apart from the legislation of Kazakhstan and so it is unclear that the law, as drafted, properly cross refers to the Criminal Code. Further, Kazakhstan has offenses of preparation for grave and especially grave crimes and for attempts to commit medium grave, grave and especially grave crimes under Article 24 of the Criminal Code. Therefore, in the context of terrorism offenses, a preparation and attempt offenses are only available for Propaganda of Terrorism or public appeals for the commission of an act of terrorism (Article 233-1) and the Creation and Leadership of a terrorist group and participation in its activities (Article 233-2). Persons can be charged with a preparation or attempt of crime even if the terrorist act itself is not completed.

There is no independent basis for instituting criminal proceedings for violations of provisions that relate to the implementation of the UN freeze lists. Nor is there any provision in the law of Kazakhstan on engaging in any financial or economic transaction with a person or organization whose name appears on an international list being a violation of Kazakhstan law and, in turn, being a criminal offence.

Scienter (4)

In Kazakhstan, the offense of ML applies to those who knowingly engage in ML. Article 25 of the Criminal Procedure Code defines proof, and provides that the court may make an analysis of the proof of the case submitted to the court and assess the “internal confidence and proofs” guided by the law and their conscience.

The authorities believe that this gives the judge discretion to consider and take account of objective factual circumstances in the case. Knowledge of some wrong doing is required but the court has discretion regarding the proof of that level of knowledge.

Legal entities have criminal liability in Kazakhstan. Some of the most used predicate offenses such as Article 222, Tax Evasion by Legal Entities, and Article 229, False Entrepreneurship, relate specifically to legal entities.

Adequacy of Legal Means and Resources

The offense of ML as such is criminalized by the Article 193 of the Criminal Code. Terrorism is criminalized by the Article 233 of the Criminal Code. According to Article 1 of the Law of the Republic of Kazakhstan of July 13, 1999 No 416-1 "On combating of Terrorism" (with changes introduced by the Law of Republic of Kazakhstan of February 19, 2002 No 295-II): "financing of terrorist organization or of terrorists" falls under definition of the "terrorist activity" (and not "terrorism"). The Criminal Code does not criminalize financing of terrorism as such.

There appear to be no other laws, bylaws, or rulings that could help to enforce an implementation of the Article 193 of the Criminal Code. This can to some extent explain that the law enforcement community tends to use articles of the Criminal Code on predicate offenses generating potentially large proceeds (i.e., Articles 190 (Illegal Entrepreneurship), 192 (False Business Entrepreneurship), 221 (Tax evasion by physical persons), 222 (Tax evasion by legal entities), 197 (Fraud)) much more frequently than Article 193 to prosecute economic crime.

Experts in the Prosecutor General's Office feel that the situation could be rectified by adopting special AML/CFT law providing for monitoring of financial transactions and establishing a competent authority for financial monitoring.

Analysis of Effectiveness

Kazakhstan has signed the international conventions that are directly relevant for AML/CFT legislation, with the exception of the Palermo and the Strasbourg Conventions. The Vienna Convention has been signed and ratified although it has not been fully implemented. The UN Security Council Resolutions relating to the financing of terrorism are not implemented by Kazakhstan, although the various lists are forwarded by the government to the relevant competent authorities and also circulated to various ministries for review and investigation. The private sector is complying with the process on a voluntary basis. To date, no names have matched names on the UN lists. Only one name has matched the US State Department list, which are also circulated by the National Security Council. The US State Department was informed. No money was in the account.

The criminal offense of ML under Article 193 does not fully comply with the international standards set forth by the Vienna, Strasbourg, and Palermo Conventions. It covers self-laundering, and applies to laundering committed by legal persons. The main area (scienter) requirement for ML is "knowingly." Article 25 of the Criminal Procedures Code authorizes the judge to consider the law and their conscience in considering cases. The authorities are firmly of the view that this allows the judge to consider objective factual circumstances in the case, among other things. Few cases have been tried on money laundering so far, so a careful evaluation of case outcomes and developing law is important, since it will facilitate making appropriate adjustments in the provisions with a view to ensure a successful ML prosecution program.

The penalties for ML range from a fine of T 460,000 to fines of T 644,000 (approximately US\$ 3,500 and US\$4,600, respectively), or six months in jail to a maximum of seven years in jail, and confiscation of all property of the defendant (not just the proceeds of crime). The criminal fines are low when compared with penalties in many other jurisdictions.

The current definition of money laundering does not meet the international standards. In order to meet the definition of ML, as set out in the international conventions, the following elements or concepts should be added to the definition of ML:

1. directly or indirectly derived property
2. possesses, uses the property

3. (knowingly) or having reason to believe the property is derived from
4. acts or omissions which constitute an offense
5. in Kazakhstan or outside Kazakhstan
6. liability for conversion or transfer of property
7. with the aim of concealing, disguising the illicit origin (of the property)
8. anyone who renders assistance to another for any of the above.

These elements should be incorporated into the definition of money laundering so that where the predicate crime has occurred outside Kazakhstan but where proceeds from that activity have been laundered through Kazakhstan, the authorities in Kazakhstan could investigate and freeze the proceeds. Similarly, conversion of property provisions should be added to the definition of money laundering so that where a defendant has converted the proceeds into other property or commingled the money with legitimate money, that other property can be frozen or seized and later forfeited after conviction.

While predicate offenses which generate proceeds of crime are caught by the current definition of money laundering, in practice, the crimes which are being targeted for a parallel money laundering investigation and prosecution are a small number of tax evasion crimes. Specifically, Article 190 (Illegal Entrepreneurship), Article 192 (False Business Entrepreneurship), Article 221 (Individual Tax Evasion), Article 197 (fraud), Article 222 (Legal Entities Evading Taxes) and Article 229 (False Entrepreneurship) are the offenses investigated for money laundering. While these may be the most common offenses associated with money laundering, they are not the only offenses that generate proceeds of crime. A wider scope of cases should be included in ML investigations. Foreign crimes may serve as predicate offenses only in cases where there has been a foreign conviction. There have not, however, been specific cases where this has been tested.

Financing of terrorism is not criminalized in the Criminal Code but is defined under terrorist activity in the *Law of the Republic of Kazakhstan of July 13, 1999 No. 416-1 on Combating Terrorism (with changes introduced by the Law of the Republic of Kazakhstan as of February 19, 2002 No 295-II)*. This does not meet the requirements under the ICSFT. While there are general prohibitions against terrorist activity occurring in the Republic of Kazakhstan listed in Articles 20 and 21 of the above law, these provisions are not enough to satisfy the requirements under the international standards.

The use of the preparation and attempt offenses in the Criminal Code of Kazakhstan to address the financing of terrorism also do not meet the requirements of the ICSFT. The preparation offense covers only grave and especially grave crimes, while attempt covers medium grave, grave, and extremely grave crimes. Attempt is therefore not available for Article 233 terrorism offenses (general terrorism offenses), but are available only for the more serious crimes of propaganda of terrorism or public appeals for the commission of the act of terrorism (such as bringing in an Islamic government in Kazakhstan by the overthrow of the current system) or the creation and leadership of a terrorist group or the participation in its activities. The latter offense is wider in scope than the former and could include financing of terrorism, but still requires proving the existence of a very specific functioning terrorist group as part of the element of the crime, and it is usually reserved for only the most serious cases. In this respect, it is narrower than the ICSFT, which covers crimes defined in nine international treaties appearing in the annex to the Convention as well as generically defined terrorism activity.

The UN Resolutions, particularly Resolution 1373 have not been fully implemented. There is no law requiring financial institutions and other relevant bodies to review the lists and report on their findings. However, an Order has been issued by the FSA to banks requesting review of clients against such lists, but it is not yet an enforceable obligation, thus, no penalties can be imposed for non-compliance until it becomes a mandatory obligation. The use of these lists to screen existing and potential customers is not audited. Currently this process is therefore implemented in Kazakhstan on a voluntary basis. Should a name on the UN list be matched to a name at a financial institution in Kazakhstan, no freezing of assets could take place, until there had been a separate court ruling by a judge in Kazakhstan that this person was deemed to be a terrorist within Kazakhstan. While the Prosecutor's office has indicated that this action could be taken quickly, it is an impediment to the "without delay" requirement of the UN Security Council resolutions. The mission was advised that when the law on Financial Monitoring is passed, this will be addressed.

<p>Both the ML and the terrorism offenses have provisions regarding exemption from criminal liability if persons come forward and confess either before the crime is committed or after it has been committed as listed in Article 193, note 2 and Article 233, Remark. The authorities advised that these provisions were in place in response to EU and Amnesty International requests for a lessening of the criminal sanctions within Kazakhstan. Furthermore, most prisons were overcrowded and, in light of this, three general amnesties have been issued. While these amnesties and exceptions from criminal liability do not extend to the more aggravated crimes of ML set out in Articles 193(2) and 193(3), and terrorism as set out in Article 233-1 and Article 233-2, they do apply to ML as set out in Article 193(1) and Terrorism set out in Article 233. The combination of these provisions has resulted in a number of cases for ML being terminated. The mission questions whether the EU or Amnesty International specifically intended for ML and Terrorism crimes to be subject to these considerations and suggests that the policy of leniency with regard to both ML and terrorism be reviewed.</p> <p>Regarding scienter, while it appears that Article 25 of the Criminal Procedures Code does give the court discretion, actual knowledge is very much the preferred and accepted standard. It is unclear whether any cases of ML have been decided on the basis of “objective factual circumstances.” All cases so far have been tried on the basis of actual knowledge.</p> <p><i>The mission believes that the legal means and resources in Kazakhstan currently are not adequate to enable an effective implementation of AML/CFT.</i></p>
<p>Recommendations and Comments</p> <ul style="list-style-type: none"> - Amend the definition of money laundering in Article 193 of the Criminal Code, so that the definition meets current international standards as set out in the international conventions. Specifically, extending the predicate crimes to include those crimes occurring outside Kazakhstan which would be a crime if committed in Kazakhstan. The proceeds of such foreign predicates then laundered through Kazakhstan should give rise to an investigation and freezing or seizing of property in Kazakhstan. Further, direct, indirect and converted proceeds should be considered in the definition of proceeds of crime and consequently should be subject to freezing or seizing. Both acts and omissions should be considered in offenses and possession and use of the property should also give rise to money laundering. - Train officials so that all officials realize that money laundering and illicit proceeds can exist alongside almost any offense, which generates illegal proceeds, including drugs offenses, illegal weapons trade, and not only tax and related offenses. - Create an offense of financing of terrorism in the Criminal Code. - Sign, ratify, and implement the Palermo and Strasbourg Conventions. - Confirm ratification of the Vienna Convention and implement its provisions. - Fully implement the ICSFT Convention. - Implement the Security Council Resolutions regarding the lists of potential terrorist so that no separate specific court order need be issued by the court of Kazakhstan to effect an immediate freeze of assets. - Review amnesty and exemption for criminal liability for ML and Terrorism as currently set out in both the criminal code and the declarations of general amnesty. - In the view of the mission, the authorities should focus more on building an effective AML system. The system should provide for instruments allowing law enforcement and prosecutors to follow proceeds of crime, when conducting investigation. - Kazakhstani Legislation needs a comprehensive AML /CFT law and adequate institutions to enforce it.
<p>Implications for compliance with FATF Recommendations 1, 4, 5, SR I, SR II</p> <p>FATF 1: Materially Non-Compliant. ICSFT not fully implemented as no financing of terrorism offence in compliance with the ICSFT.</p> <p>FATF 4: Materially Non-Compliant. Money Laundering Definition incomplete.</p> <p>FATF 5: Largely Compliant: Objective factual circumstances available to the court in Article 25 of the Criminal Procedures Act, but no ML cases on point.</p> <p>SR I: Materially Non-Compliant: ICSFT not fully implemented. No legal provisions regarding 1373.</p> <p>SR II: Non-Compliant: FT not criminalized.</p>

<i>II—Confiscation of proceeds of crime or property used to finance terrorism</i> (compliance with criteria 7-16)
Description
General Overview <p>The Prosecutor General’s Office (“PO”) is the state body vested with the authority to initiate criminal proceedings as set out in the Constitution. The PO represents the State’s interests in court and also provides the highest supervision for law enforcement, including the operative functions of the police and other agencies. The PO also supervises the enforcement of laws, decrees and other legal and normative acts. The PO does not take preliminary investigations as these are undertaken by law enforcement pursuant to Article 83 of the Constitution. Article 84 of the Constitution specifies that investigations should be separate from the criminal justice proceedings, but that the PO has supervisory authority over such investigations. The PO reports directly to the President and is the coordinating body for law enforcement and special bodies. The PO has set up a coordinating counsel in the PO’s office, comprising top officials of law enforcement and special bodies, which the Prosecutor General chairs.</p> <p>In Kazakhstan, each region, called an oblast, has a regional prosecutor, and each oblast is divided into 10-15 districts. There are 300 district offices in Kazakhstan within the 15 oblasts. There are also three transport prosecutors, who have jurisdiction over the enforcement of laws pertaining to rail, air, and water.</p>
Confiscation (7) <p>Preliminary investigations regarding ML begin with the state bodies, which have jurisdiction over banking, customs, and tax legislation. Terrorism and FT investigations begin with the National Security Committee, the Ministry or Interior, and the Agency for the Fight Against Economic and Corruption Crimes) (AECC). The AECC and other bodies have wide powers of investigation, which are delineated in the Criminal Procedures Code. The investigative authorities may approach financial institutions and other bodies during this time and request information, although financial institutions and other bodies are not obliged to provide such information. The authorities have 10 days to complete a preliminary investigation, and then either raise the matter up to the PO or close the case.</p> <p>In order to raise the matter up to the PO, the relevant authorities only need produce an “adequately justified and motivated resolution.” In practice, this is a low threshold. Once this has been met, the PO will sign and stamp the resolution drafted by the relevant body. With this signed and stamped resolution, the investigative body may request any information and freeze any money or provisionally seize any property. If the matter involves bank secrecy regarding the accounts of natural persons, the Agency for the Fight Against Economic and Corruption Crimes will bring the resolution to the General Prosecutor himself, who will sign the resolution if the resolution is “adequately justified and motivated resolution.” For legal persons, authorized persons at the PO’s office may sign and stamp the resolution. Authorized persons in the PO, who may sign and stamp a resolution, include the General Prosecutor for each oblast and his/her deputy as well as the General Prosecutors with jurisdiction over rail, air, and water. PO’s signed and stamped resolutions may be challenged in court, in cases where the defendant feels that a mistake has been made. The signed and stamped resolution will allow investigative bodies to search for a seize information, freeze accounts and seize property. Money subject to freezing will be moved to the treasury for safekeeping before trial, and physical assets will be moved to a secure physical storage site, which will be controlled by a third party, who is under contract to the State until a decision is rendered by the court. Confiscation of both money and property requires a final judgment from the court.</p> <p>Articles 115 and 117 of the Civil Code define property widely. The definition included real and immovable property, movable property, and intangible property, including rights.</p> <p>The Criminal Procedure Code provides for the confiscation, after conviction, of laundered property, of proceeds from the commission of offenses, including money laundering offenses and offenses relating to the financing of terrorism (insofar as it is currently defined in the law), and of instrumentalities used or intended for use in the commission of offenses. Specifically, the PO has power to seize property under the following articles:</p>

Article 161 of the Criminal Code (Seizure of property), which says that an investigator can seize property on authorization of the prosecutor; and
Article 199 of the Criminal Code (Powers of the head of investigation team), which states that in the case of team investigation, the prosecutor who is the head of the team has power to take decisions solely by himself to seize property or proceeds.

The following are subject to confiscation/ forfeiture:

- property obtained, in whole or part, by means of an offense, or from the proceeds of the offense,
- property in relation to which the offense was committed,
- property used to commit or prepare for the offense, and
- property intended for the commission of an offense and any other property owned by the defendant.

Value and property based provisions are available in the law of Kazakhstan. The general provisions of the Criminal Procedure Code and the Public Prosecution Law provide for both value based and property based confiscation. Article 193 of the Criminal Code allows the judge discretion on whether to confiscate proceeds or not and in what amount. Amounts of either less than or more than the criminal proceeds may be forfeited. The court has wide discretion to also make an order for payment of an amount of money equivalent to the illegal profits gained or for an amount in excess of the illegal profits gained. Alternatively, the court has the discretion to order that no confiscation take place. Confiscation cannot occur separately from the criminal trial. Such proceedings must be conducted as part of the trial for the conviction of the crime. Confiscation is discretionary rather than mandatory and requires a criminal conviction.

In light of the broad discretion of the court, a court could order a sentenced person to pay a sum the court estimates to represent illegally obtained profits or advantages. An expert assessor will be appointed by the court to conduct an investigation into the "cost damage." In cases where there are multiple charges on multiple crimes, seizure cannot technically occur for an offense other than the offense of conviction although, again, for the offense of conviction, more property may be confiscated than that which represents the proceeds of that particular crime, if the judge so chooses to make that order. There are no specific provisions regarding confiscation in cases of other related crimes which have not been proved, even if there is reasonable evidence connecting the offender to the other crimes. There are no provisions regarding the standard of evidence that it is more likely than not that the property represents proceeds of crime. In the law, a specific connection between the assets and offense is required but in practice there is broad judicial discretion for confiscation of all assets held by a defendant. Article 51 of the Criminal Code does provide that defendants may keep only property that is essential to them (for example, clothing, one refrigerator, and blankets), but this does not extend to real property or business assets.

While the PO's office can move quickly with regard to domestic requests for freezing assets, if there is a need to act quickly because of an incoming foreign request for a freeze, the authorities have a more difficult time as all foreign requests must be in the proper form and are subject to review in Astana for both form and content. Authorities feel that they act expeditiously with regard to foreign requests, although they admit that the vast majority of such requests come from the CIS countries. Whether in response to a domestic or international request, a freeze order may stay in effect until trial, however far in the future the trial date is set.

Property may be seized and confiscated after trial where a person has abandoned the jurisdiction. A trial may be held and sentence passed in his/her absence. Where no trial is held, the property will be returned to the individual or his family, if he has absconded, when the statute of limitations requires if not before. Property may be frozen for anywhere from 5 to 10 years depending on the offense. Where a defendant dies before trial, however, any proceeds frozen or seized would be returned to the defendant's family or other person according to the laws of succession.

Third Parties: Confiscation of goods belonging to third persons, where the third party knew or should reasonably suspect the goods represent the proceeds of crime, is possible under both the Criminal Procedures Code and the Civil Code. Further, Article 29 of the *Law on the Prosecutor's Office* allows the PO to restrict the sale or disposition of property or to seize property before trial in such cases. Such persons may also be ordered to pay an

amount of money equivalent to the proceeds held. Gifts are also subject to these provisions. This applies to both natural and legal persons. Assets transferred to legal entities may be covered as long as there is a showing of knowledge on the part of the legal entity. There is no time restriction on review of possible fraudulent preferences or fraudulent conveyances so that property transferred well before a criminal investigation begins may also be subject to seizure before trial and confiscation after trial.

Specifically, the procedure of confiscation of connected third party's property is regulated by:

Article 161 of the Criminal Code (Seizure of property),
Chapter 5 of the Criminal Code (Civil suit in criminal procedure),
Article 157 of the Civil Code (Void transactions and consequences of invalidity),
Article 158 of the Civil Code (Invalidity of a transaction, which contents does not meet legal requirements).

Property of Organizations: The provisions on confiscation, forfeiture, and seizure are applicable to investigations, prosecutions, and convictions under Article 233-2 of the Penal Code, which makes participation in an organization whose object is to commit crimes an offense. Similar provisions are available in the Criminal Procedures Code for legal entities. For example, Articles 192 and 222 deal specifically with corporate offenses. Property subject to seizure and confiscation after trial is not limited to the property of the accused.

Confiscation without criminal conviction: This is not possible in the civil law system in Kazakhstan.

Powers to identify and trace (8)

Under the Kazakhstan Code of Criminal Procedure and the Law on the Prosecutors Office, powers to identify and trace assets are granted broadly. These powers are available even if a formal investigation against an identified target is not yet open. The suspicion that a criminal offense has been committed will be enough. Once a resolution is signed and stamped by the PO, the investigative authorities have the right to request documents, seize documents, and provisionally freeze and seize money and property, respectively. Witness statements may also be taken and do not need a signed and stamped resolution. Such resolutions are needed for restriction of the freedom of persons, regarding disclosures from banks (bank secrecy), seizure of records, and restrictions on personal privacy (such as eavesdropping on telephone conversations). This information may be generated domestically or it may come from overseas pursuant to an international request for assistance.

Rights of bona fide third parties (9)

Innocent third party rights are protected in the Civil Code. Anyone with an interest in property may file a claim in writing, have it heard and pursue a lifting of a freeze on a timely basis. Specifically, innocent (bona fide) party rights protection is regulated by:

Article 261 of the Civil Code (Request of property from bona fide acquirer), and
Article 262 of the Civil Code (Limitations for requests of money and bearer securities).

Authority to void contracts (10)

The Criminal Procedure Code and the Article 29 of the Law on the Prosecutors Office provide the authority for the voiding of contracts that aim to frustrate seizure, confiscation, or forfeiture orders. The authorities noted that a contract person knows or should know will prejudice authorities in a recovery is unenforceable. Fraudulent conveyances and fraudulent preferences may also be voided. There are no time limits on transactions which may be considered a fraudulent preference or a fraudulent conveyance.

Statistics and training (11 and 12)

Statistics are compiled by the Committee on legal statistics and special registration under Prosecutor General according to Republic of Kazakhstan Law "On state legal statistics and special registration", May 22, 2003 № 510-II. According to Article 9 of the "Law on Prosecution", the Chief Prosecutor's Office along with relevant

authorities shall:

- Take part in the preparation of methodology regarding the registration and statistical reporting of crime, situation concerning the solution of crime, and course of proceedings in criminal matters;
- Provide statistical reporting, summarize, and improve prosecutorial and investigative practice, arrange the implementation of scientific-technical means.

According to Articles 86 and 87 of the "Law on Courts and Judges," the Ministry of Justice shall take measures for keeping judicial statistical records, summarize, and analyze the statistical reporting concerning judicial activities and inform courts about the results.

The Committee on legal statistics and special registration does keep nationwide statistics on the amounts of property frozen and seized, relating to ML and the predicate offenses. The Committee keeps overall statistics on the amounts of property confiscated through courts decisions, though this statistics features no offenses layout. The Customs Department (Customs) keeps its own statistical data on the amounts of property seized and confiscated.

As for freezing of assets belonging to persons from the lists of the UN Security Council resolutions, the evaluators were informed that the law enforcement authorities had not yet had any cases of freezing. Data presented in tables was extracted from far more detailed information provided by the authorities. The following are to be used for illustrative purpose only.

Value of Property Frozen and Seized in 2003 (In millions of tenge)

	<i>Damage Inflicted</i>	<i>Property Frozen</i>	<i>Property Seized or Voluntary Reimbursed</i>
<i>Article 175 (Theft)</i>	3,282.130	12.896	617.748
<i>Article 178 (Robbery)</i>	80.403	1.392	32.675
<i>Article 179 (Pillage)</i>	685.932	0.142	55.962
<i>Article 181 (Extortion)</i>	23.840	4.852	5.089
<i>Article 190 (Illegal Entrepreneurship)</i>	190.024	9.094	55.744
<i>Article 209 (Economic smuggling)</i>	136.021	51.567	135.432
<i>Article 221 (Tax evasion by physical persons)</i>	66.691	0.966	4.599

Data source: Committee on legal statistics and special registration.

Property Confiscated Through Court Decisions by Customs (In millions of tenge)

	<i>2002</i>	<i>2003</i>
<i>Economic crime offenses</i>	13.5	324.0
<i>Criminal smuggling offenses</i>	20.0	342.5
<i>Administrative offenses</i>	96.0	128.4

Data source: Agency of Customs Control.

Kazakhstan law enforcement staff has received training by international trainers on general issues of AML/CFT. An OSCE-sponsored seminar on AML/CFT for law enforcement community has been held in Almaty in 2002. Last year, executives had undergone training at courses run by the International Law Enforcement Academy in Budapest, at a seminar in Istanbul, Turkey, and at an OSCE and UN sponsored conference in Astana. Law enforcement experts attended a seminar for banking business on AML issues in Almaty. The World Bank conducted AML/CFT Training via teleconference. In January 2004, executives attended an IMF seminar on new FATF recommendations in Vienna.

The Agency for the Fight Against Economic and Corruption Crimes runs two divisions, one preparing personnel

for the Agency itself and the other for Customs. Studying legislation related to the freezing, seizure, and confiscation of property is in curriculum. Advanced training or further education is planned for the nearest future.

The Ministry of the Interior runs its own Academy, as well as the Committee of National Security. There seems to be no training of law enforcement and prosecutorial authorities specially related to the issues of freezing, seizure, and confiscation of property related to AML/CFT. The issues are a part of more general training for enforcing AML/CFT laws.

Freezing for TF (13, 14)

In the area of FT, no person or institution in Kazakhstan, in particular those authorized to hold accounts, is obliged to freeze without delay funds or other property belonging to terrorists or terrorists organizations identified by the United Nations SCRs. United Nations Security Council Resolutions (UNSCR) containing lists of names (specifically UNSCR 1267 and 1390) have not yet been implemented. A law requiring such measures, the Financial Monitoring Law, is currently being drafted. In the meantime, authorities in Kazakhstan are voluntarily complying with the UN SCRs. In addition, if a reasonable suspicion arises that funds belong to terrorists or terrorist organizations, prosecutors may institute criminal proceedings, and apply for appropriate measures in court (i.e. that this person or legal entity is deemed by a judge in Kazakhstan to be a terrorist). At that point, freezing and seizing of property of the terrorists is available.

13.1 Kazakhstan authorities were not in position to provide the evaluators with any official statistics on the amounts of property frozen relating to FT as well as number of individuals or entities whose property have been frozen. It appears there have been no cases of freezing property relating to FT.

As for freezing of assets belonging to persons from the lists of the UN Security Council resolutions, the evaluators were informed, that the Kazakhstan authorities were empowered to freeze assets only belonging to entities, which were considered to be terrorist organizations by the court.

Under Kazakhstan legislation, a prosecutor is empowered to seize property and freeze banking accounts even before opening a criminal case, i.e. within the framework of "prosecutor's audit" procedure.

Procedures for disseminating freeze lists

Procedures have not yet been set forth. Currently, distribution of lists is done on a voluntary basis. The NBK distributes the lists to Financial Initiations. The ministry of interior and the National Security Committee also distribute the lists to their regional offices for review. The AECC distributes the lists to its regional offices, which check land registries, auto registries, company registries, and some public organizations. If there is a match or a possible match, the matter is referred to the PO, who must refer the matter to court for a court ruling by a judge in Kazakhstan that such a person or entity is a terrorist or terrorist organization.

Asset Forfeiture Fund (15)

Kazakhstan law does not provide for an asset forfeiture fund for confiscated property. Confiscated assets go into the general public funds. There is currently a restriction on separate funds. Such funds are currently forbidden by the budget law. Seized assets are managed by the authority that has exercised the seizure (Customs, the Agency for the Fight Against Economic and Corruption Crimes). Assets such as gold and precious stones are sent for storage at the NBK. Maintenance costs are paid out of the state budget. The seizing authority is responsible for disposition of the property once authorized to do so by an interagency committee after a confiscation order has been issued. Interlocutory sales are permitted for perishable commodities.

Asset Sharing (16)

The PO in Kazakhstan may freeze or seize property after receiving a proper international request based either on

a treaty or on the procedures laid down in the Criminal Procedure Code for non-treaty countries. The PO may only apply to confiscate property when in receipt of a foreign judgment from a foreign court (whether a treaty or non-treaty country). There are no provisions either in bilateral treaties or in the Criminal Procedures Code for sharing of confiscated property.

Analysis of Effectiveness

The confiscation regime in Kazakhstan has both property and value-based provisions but it is not mandatory. The regime applies to economic benefits deriving from any criminal offense. Confiscation requires a criminal conviction, but freezing and seizing are available on a provisional basis. Assets and proceeds from conduct outside the offense are subject to provisional measures and may be subject to confiscation at the sole discretion of the judge. Defendants, who have fled may, be prosecuted when absent, and confiscation of a fugitive's assets is also permissible. Where a defendant dies before prosecution, assets are returned to the defendant's family or others pursuant to the laws of succession. If there are no successors, the assets would be forfeited to the state. Generally, there is no system for identifying and tracing property which is subject to confiscation.

When applied to ML or FT (insofar as they are defined in the laws of Kazakhstan), confiscation applies to proceeds, instrumentalities, laundered property, income or profits derived from the proceeds as well as the value of the proceeds and laundered property.

Assets transferred to legal entities are subject to confiscation under the general rule that assets in the hands of third parties are reachable based upon the third party's knowledge of the illicit nature of the assets: Articles 161 and 199 of the Criminal Procedure Code. The seizure regime under the Criminal Procedure Code empowers prosecutors to secure assets or other property that may become subject to confiscation, and records which may assist the court and that will demonstrate illegally obtained profits. Since confiscation system in Kazakhstan is in part value-based and a purpose of seizure is to safeguard property in the event of an eventual confiscation order, the seizure may apply to substitute assets that are legal property as well as illegal. Prosecutors and police officials noted that freezes of financial accounts can be effected quickly.

Specific provisions exist for the protection of bona fide third parties. Provisions for voiding contracts that aim to frustrate claims resulting from the operation of AML/CFT laws are adequate.

The confiscation regime in Kazakhstan provides for the confiscation of proceeds relating to participation in a criminal organization including a terrorist group if a person is charged with participation in a group. Confiscation can occur of all funds that the defendant has control of that represent criminal proceeds or instrumentalities, even from criminal offenses that he did not take part in.

The UNSCRs relating to the prevention or suppression of FT have been not been effectively implemented in Kazakhstan, although the authorities are complying with their provisions on a voluntary basis. The authorities cannot freeze, without delay, funds or other property of terrorists or terrorist organizations listed by the UN or by individual governments without first initiating a court action in Kazakhstan. While this may be done expeditiously, no action regarding freezing can be taken until a judge in Kazakhstan has ruled that the individual or the legal entity is a terrorist or a terrorist organization.

Kazakhstan does not have an asset forfeiture fund, and it is not able to share confiscated assets with other jurisdictions when the confiscation occurs at foreign request.

Kazakhstan legislation lacks provisions related to FT. Therefore, there is no statistics on the amounts of property frozen relating to FT, and the number of individuals or entities whose property have been frozen. Authorities keep statistics on the amounts of property frozen, seized, and confiscated relating to ML and the predicate offenses. As FT is not criminalized there is no statistics on FT. The law enforcement community has gained some initial training on the issues of freezing, seizure, and confiscation of property related to AML/CFT. The need to get further training provided by international trainers was underlined by the majority of Kazakhstani experts, especially those dealing with economic crime (Agency for the Fight Against Economic and Corruption Crimes).

Recommendations and Comments
<ul style="list-style-type: none"> - Make confiscation of criminal proceeds in ML and TF matters mandatory, so that the courts are obliged to consider the issue, and to the extent proceeds exist, confiscate them. - Enact a law regarding the implementation of the UNSCRs, requiring financial institutions to immediately freeze any identified accounts, requiring the processes of financial institutions subject to review by competent authorities, and the failure to comply subject to sanction, and obviating the requirement for a judge in Kazakhstan to pronounce judgment regarding natural and legal persons being terrorists -<i>Criminalize terrorist financing. The statistics on the amounts of property frozen should be included into the list of statistical data.</i> - <i>Put in place a system of collecting, processing, and disseminating more detailed confiscation data for trial and post-trial stages of prosecution procedure.</i> -<i>Training of law enforcement authorities is urgently needed on the issues of freezing, seizure, and confiscation of property related to FT. The issue could be a matter of priority in plans of rendering technical assistance to the state.</i>
Implications for compliance with FATF Recommendations 7, 38, SR III
<p>FATF 7: Materially Non-Compliant: Individual judges have the discretion to confiscate or not confiscate proceeds of crime. No system in place to identify and trace property subject to confiscation.</p> <p>FATF 38: Materially Non Compliant: No asset sharing and no statistics maintained on FT. No separate asset forfeiture fund is permitted under Kazakhstani law.</p> <p>SR III: Materially Non-Compliant. Unable to freeze expeditiously regarding names on the UN lists. Must apply to court and receive a court order in Kazakhstan before freezing can take place.</p>
<i>III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels (compliance with criteria 17-24)</i>
Description
<p>FIU (17)</p> <p>Currently, there is no Financial Intelligence Unit (FIU) in Kazakhstan although the authorities are actively working on creating such an authority.</p> <p>Additional Documentation (18)</p> <p>Currently, the AECC must obtain a signed and stamped resolution from the PO’s office as part of a criminal investigation before information to assist in analysis of financial transactions can be obtained.</p> <p>Access to Law Enforcement Information (19)</p> <p>Currently, the AECC must obtain a signed and stamped resolution from the PO’s office as part of a criminal investigation before being able to obtain financial, administrative or law enforcement information.</p> <p>Sanctions and Penalties (20)</p> <p>As there is no duty to report transactions, there is no penalty for failure to report.</p> <p>Dissemination of Information and information sharing with foreign counterparts (21,22)</p> <p>Not applicable.</p> <p>Statistics and Staffing (23,24)</p> <p>Not applicable.</p>

<p>Analysis of Effectiveness</p> <p>Since there is no FIU and no duty on financial institutions or other relevant bodies to report suspicious activities, the AML/CFT framework of Kazakhstan is significantly weakened.</p> <p><i>There are not statistics on the FIU or other competent authority activities due to the lack of such authorities. The lack of an FIU in Kazakhstan greatly impedes its ability to create a systematic approach to combat ML/FT.</i></p>
<p>Recommendations and Comments</p> <ul style="list-style-type: none"> - Creation of a FIU should be a priority for the authorities in Kazakhstan. - Financial institutions must be under a duty to file suspicious transaction reports to the FIU. The FIU should issue guidelines for the identification of complex or unusual transactions, and suspicious patterns of behavior. The FIU should be able to obtain additional documentation from reporting parties to assist in its analysis of financial transactions. The FIU should have access to financial, administrative, and law enforcement information on a timely basis to enable it to adequately undertake its responsibilities. The FIU or a similar entity should also be able to order sanctions or penalties against reporting parties for failure to comply with their reporting obligations. - The FIU must be an independent agency, which serves as a “buffer” agency that will ensure respect for principles of confidentiality of financial data, and ensure that financial information forwarded to law enforcement officials is limited to that which further investigation and prosecution is warranted. The information reported to the FIU concerning suspicious transaction should also be protected from other government officials and authorities, and it should not be used for tax collection purposes. - The political independence of the FIU is very important as well as the perception of credibility and trust from the point of view of financial sector entities. If the FIU is created in a manner that there is any perception that it can be subject to undue political influence, or that the data it handles and suspicious transaction report information will be abused or used for purposes beyond detection and prevention of money laundering, financial entities will not report suspicious transactions, as doing so could be subjecting their clients to possible inappropriate actions by government and authorities and officials. - <i>Kazakhstan must adopt legislation on competent authorities providing for keeping all the necessary statistics. Authorities should adopt without delay legislation providing for establishment of FIU which meets all requirements of the competent authority of this kind.</i>
<p>Implications for compliance with FATF Recommendations 14, 28, 32</p> <p>FATF 14: Non-Compliant (with regard to the FIU). No FIU in existence. FATF 28: Non-Compliant (with regard to the FIU). No guidelines issued. FATF 32: Non-Compliant (with regard to the FIU). No FIU in existence.</p>
<p><i>IV—Law enforcement and prosecution authorities, powers and duties</i> (compliance with criteria 25-33)</p>
<p>Description</p> <p>Proper Investigation of ML/FT Offenses (25)</p> <p><i>Investigators and inspectors of the law enforcement authorities have the responsibility for ensuring a proper investigation regarding the criminal matters, the investigation of which is within their competence. According to “the Law on Prosecution,” with an aim to ensure the execution of criminal prosecution, the prosecution office shall provide procedural guidance to the preliminary investigation, supervise the implementation and exercise of laws, and examine and summarize the execution of legislative acts in this area. Under the Law and Criminal Procedure Code, the prosecutor has power to hand over a case from one investigator/law enforcement agency to other investigator/law enforcement agency if the former are not relevant to investigate the case.</i></p> <p><i>Under Presidential Decree on the procedure of considering citizens’ complaints, the office must respond within 15 to 30 days to such claims.</i></p> <p><i>Major law enforcement agencies (Ministry of Interior, Committee of National Security, Agency for the Fight Against Economic and Corruption Crimes and Customs) do have in their structure specialized divisions of internal security responsible for proper execution of operational procedures.</i></p>

Legal Basis for investigative techniques (26)

Special investigative techniques, as listed below, are available in connection with ML and predicate offenses but must be approved by the General Prosecutor or the Deputy Prosecutor General pursuant to Article 4 of the Criminal Procedure Code regarding operational and investigative activity:

- undercover operations/covert investigations by police officers or with civilian assistance;
- controlled delivery (considered a form of systematic observation);
- search of premises and persons;
- recording of telecommunications and of confidential communications;
- provision of information from telecommunication provider;
- systematic observation; and
- surreptitious tracking and listening devices.

These investigative techniques are available for the investigation of criminal offenses, but only with the signed and stamped resolution of the PO.

26.1 Ministry of Interior, the Agency for Combating Economic and Corruption Crimes, and the Committee of National Security are empowered by the Law on “Operative Investigation Activity” and by the Criminal Procedure Code to use special investigative techniques. They can do it irrespective of criminal offense being investigated.

The range of techniques is as follows:

- *undercover operation/covert investigation by officers or with civilian assistance;*
- *controlled delivery (considered a form of systematic observation);*
- *search of premises and persons;*
- *recording of telecommunications and of confidential communications;*
- *provision of information from telecommunication provider;*
- *systematic observation; and*
- *surreptitious tracking and listening devices and cameras.*

Article 8(1) of the Law on Operational and Search Activities (1994) empowers relevant agencies to “use behavioral models simulating criminal activity.” The use of such techniques may or may not require the approval of the courts or the PO depending on the stage of the investigation or prosecution proceedings.

Ability to compel financial records (27)

Law enforcement authorities in Kazakhstan are able to compel the production of bank account records, including customer identification records upon production of a signed and stamped resolution from the PO, once a criminal investigation has commenced. This resolution gives investigative authorities the power to require any follow up reports from reporting institutions regarding financial transactions, which are under investigation.

Co-operation and information sharing (28)

If during criminal proceedings it is determined that a criminal case relates to the competence of several investigative authorities, based on a substantiated decision by the Prosecutor General and his/her deputies, and with an aim to conduct a comprehensive, full and objective preliminary investigation, a joint investigative and operational group is created under the direction of a prosecutor regarding the criminal case relating to competence of several relevant executive authorities, this group consisting of investigators from the authorities in question. Coordination of the group’s activities rests with the prosecutor.

Law Enforcement and prosecution agencies structure, funding, staffing (29)

Judicial bodies carry out their activity in compliance with Constitutional Law of Republic of Kazakhstan on

Judicial System and Republic of Kazakhstan Judge Status, May 25, 2000, N132-II.

Law enforcement structures in place to combat ML/FT are as follows. Money laundering cases are investigated by the Ministry of Interior, as well as by the Agency for the Fight Against Economic and Corruption Crimes. Ministry of Interior is responsible for investigation of cases of general criminality, while the Agency for Combating Economic and Corruption Crimes goes for economic crimes. Smuggling cases are investigated by the Agency of Customs Control (the Customs).

Criminal cases related to acts of terrorism are investigated by the Committee of National Security, which holds responsibility for the nationwide coordination of other agencies' activities to combat terrorism in Kazakhstan. The Committee of National Security is responsible for direct investigation of political oriented terrorism offenses, the Ministry of Interior—for social oriented terrorism offenses.

Upon identifying terrorists' activities, any case is coordinated with the Committee of National Security. Combating terrorism is coordinated with prevention of drug offenses, weapons' smuggling, illegal human migration, etc.

The Committee of National Security, the Ministry of Interior, the Agency for Combating Economic and Corruption Crimes, the Agency of Customs Control coordinate their activities on a base of joint executive order signed by the heads of these agencies. The executive order stipulates the procedures of information exchange and interaction between the agencies on cases related to terrorism and drug offenses.

ML cases can be investigated by the body engaged in investigation of a predicate offense, though generally such a case upon identification of relevant features of ML will be referred to the Agency for the Fight Against Economic and Corruption Crimes (the handover decision is taken by the supervising prosecutor).

Each of the law enforcement structures has headquarters in Astana as well as regional and local offices.

The Ministry of Interior has recently created a special committee to deal with drugs crimes.

The committee is responsible for nationwide coordination of activities of all other governmental agencies involved into fighting this type of crimes. There are sections on organized crime in the ministry.

Within the Criminal Police Department of the Ministry of Interior, there are divisions for combating illegal turnover of weapons and for enforcing immigration policy. There are special sections for drug-related crimes and illegal weapons turnover at the regional level.

All criminal investigations in Kazakhstan are carried out under the supervision of the relevant branch of the Prosecutor General's Office.

Statistics on ML and FT investigations, prosecutions, and convictions (30)

Legal statistics is carried out by the Committee on Legal Statistics and special registration under the Prosecutor General according to Republic of Kazakhstan Law "On state legal statistics and special registration," May 22, 2003 № 510-II. According to Article 9 of the "Law on Prosecution" the Chief Prosecutor's Office along with relevant authorities shall:

- Take part in the preparation of methodology regarding the registration and statistical reporting of crime, situation concerning the solution of crime, and course of proceedings in criminal matters; and,*
- Provide statistical reporting, summarize and improve prosecutorial and investigative practices, and arrange the implementation of scientific-technical means.*

According to Articles 86 and 87 of the "Law on Courts and Judges," measures shall be taken for keeping judicial statistical records, summarize and analyze the statistical reporting concerning judicial activities, and inform courts about the results.

The Committee on legal statistics and special registration keeps nationwide statistics on the number of investigations and prosecutions. Statistics of the number of convictions is kept by the Ministry of Justice.

There are no statistics generated in regard to investigations initiated on the basis of suspicious transaction reports, since there is no system of suspicious transaction reporting in place in Kazakhstan.

Data presented in tables was extracted from far more detailed information provided. The following is used for illustrative purpose only.

<i>Number of cases registered:</i>	<u>2002</u>	<u>2003</u>
<i>Crimes against property (Chapter 6 of the Criminal Code)</i>	6,331	6,398
<i>Crimes in business sector (Chapter 7 of the Criminal Code)</i>	6,033	4,169

Data source: Committee on legal statistics and special registration.

<i>Number of cases referred to the court</i>	<u>2002</u>	<u>2003</u>
<i>Crimes against property (Chapter 6 of the Criminal Code)</i>	3,850	4,463
<i>Crimes in business sector (Chapter 7 of the Criminal Code)</i>	2,865	1,654

Data source: Committee on legal statistics and special registration.

<i>Number of specific crimes registered</i>	<u>2002</u>	<u>2003</u>
<i>Article 175 (Theft)</i>	49,003	42,957
<i>Article 178 (Robbery)</i>	8,267	9,039
<i>Article 179 (Pillage)</i>	2,471	2,279
<i>Articles 250, 259, 260, 261, 262, 263, 264, 265, 266-3 (Drug crimes)</i>	n/a	12,039

Data source: Committee on legal statistics and special registration.

<i>Number of specific crimes referred to the court</i>	<u>2002</u>	<u>2003</u>
<i>Article 175 (Theft)</i>	33,228	27,773
<i>Article 178 (Robbery)</i>	4,976	4,458
<i>Article 179 (Pillage)</i>	2,236	1,992
<i>Articles 250, 259, 260, 261, 262, 263, 264, 265, 266-3 (Drug crimes)</i>	n/a	10,063

Data source: Committee on legal statistics and special registration.

<i>Number of convictions</i>	<u>2002</u>	<u>2003</u>
<i>Article 233 (Terrorism)</i>	1	0
<i>Article 251 (Illicit weapons' smuggling)</i>	0	2

Data source: Committee on legal statistics and special registration.

Eight convictions for ML (Article 193 of the Criminal Code) were registered in 2003 (data source: Agency for Combating Economic and Corruption Crimes). Law enforcement people relate the mismatch between lots of predicate offenses and poor figures of ML convictions to the lack of experience of handling ML cases, difficulties to trace links between predicate offense, property, and its beneficial owners.

Typologies and trends on current ML and FT methods and techniques (31)

The Customs Office issues monthly bulletins on major crime patterns for dissemination among its field offices, but not for interagency use.

The other law enforcement agencies provided no information on whether they have a practice of a regular interagency dissemination of ML and FT typologies and trends. The Committee of National Security shares FT typologies on irregular basis.

Training in ML and FT (32)

The law enforcement agencies do possess capabilities to provide general training concerning the scope of predicate proceeds generating and terrorists' offenses and techniques to investigate and prosecute these offenses. See also the Description under Criterion 12.

FT, prosecution and forfeiture problems (33)

Terrorist activity fortunately is not a priority issue in Kazakhstan. The Committee of National Security had successfully prosecuted two cases of terrorist organizations in 2003.

The evaluators were not provided with any provisions setting out the general framework for confiscation proceeds of crime or property to be used to finance terrorism. The Kazakhstani law enforcement agencies did not produce any cases which resulted in freezing, seizing, and confiscating substantial proceeds of crime or property to be used to FT as such. Terrorist financing is not criminalized by the Criminal Code.

Analysis of Effectiveness

Provisions in the Criminal Procedures Code provide law enforcement authorities with the tools to investigate financial crimes and compel records for criminal investigations.

Generally speaking, in Kazakhstan there seems to be a system in place ensuring that offenses (ML included) are properly investigated. The mission expresses its reservations concerning whether the system currently is adequate to enable proper investigations of money laundering and terrorist financing offenses. The law enforcement authorities in Kazakhstan seem to be reasonably well equipped in terms of investigative processes available. A system of coordination, cooperation, and information sharing among the different government agencies is in place. When creating a FIU, special attention should be paid to ensure its close cooperation with law enforcement agencies involved in AML/CFT prosecution.

Law enforcement and prosecution agencies in Kazakhstan seem to be reasonably well structured and staffed with trained personnel to perform their functions. However, the mission expresses its reservations concerning adequacy of the funding, number of human resources, sufficiency of technical and other resources to fully perform these functions. Authorities keep statistics of the number of ML investigations, prosecutions, and convictions. There is no statistics of investigations initiated on the basis of suspicious transactions reports, as there is no such system in place. Customs uses trained personnel and modern equipment (X-ray scanners) to monitor cross border movements of large amounts of currency as well as guns and explosives.

Since FT is not criminalized in Kazakhstan, there are no statistics on FT. There seems not to be a system in place of a regular interagency dissemination of ML and FT typologies and trends. Law enforcement agencies feel that current training received from abroad is not sufficient to get the necessary knowledge for enforcing laws to combat ML and FT.

The confiscation regime in Kazakhstan seems solely to be used as an additional penalty. As for freezing assets, there is no comprehensive regulation providing a mechanism to implement the freezing without delay of assets deposited into bank account.

Recommendations and Comments
<p><i>Keeping statistics of investigations initiated on the basis of STRs and statistics on FT investigations, prosecutions, and convictions should be an integral part of statistical system in Kazakhstan. The system of interagency dissemination of ML and FT typologies and trends should be regulated in such a way that it would provide for a regular review of these. This is especially important for initial stages of creation a comprehensive AML/CFT system in Kazakhstan. There is also a need to create such a system within the framework of CIS' FIUs, taking into consideration strong economic ties, as well as traditions and common mentality of the criminal society in the former Soviet territories. Much more training is necessary for the law enforcement in order to reach modern knowledge in the fields of asset tracing, ML and FT.</i></p> <p><i>As a matter of utmost priority, once the FIU is established, there will be a need to train persons in the FIU on conducting financial investigations into ML/FT. Ideally, special units within the relevant AML/CFT designated ministries and departments should be created in order to interface with the FIU. Such ministries would include the Ministry of Interior, the National Security Office, the PO, and the NBK. Ideally, an interagency coordination committee should also be created, possibly as a continuation from the current drafting working group. Specially trained AML/CFT prosecutors would strengthen the AML/CFT framework.</i></p> <p><i>There should be also be in place a detailed and comprehensive regulatory mechanism to implement freezing and seizure of proceeds of, or used in, or intended or allocated for use in the FT. Special attention should be paid to the procedure of freezing related to the lists of UN Security Council resolutions.</i></p>
<p>Implications for compliance with the FATF Recommendation 37</p>
<p>FATF 37: Materially Non-Compliant: More international police gateways are needed as well as exchange of information between different FIUs.</p>
<p><i>V—International Co-operation</i> (compliance with criteria 34-42)</p>
<p>Description</p>
<p>Mutual Legal Assistance (34, 36)</p> <p>Kazakhstan can provide mutual legal assistance (MLA) on the basis of international treaties. If no bilateral or multilateral treaty is in force, the provisions of Chapter 55 of the Criminal Procedures Code govern and the assistance available is limited to specified measures set forth in the Criminal Procedure Code. If a bilateral or multilateral treaty is in force, the provisions of the treaty govern the execution of requests for MLA and provisions of the Criminal Procedures Code applicable to mutual assistance are used to the extent they do not conflict. No scope or types of mutual assistance are specified in the Criminal Procedures Code. Letters Rogatory are required, where there are no bilateral or multilateral treaties in existence. If no treaty is in place, the scope and nature of non-treaty assistance is at the discretion of the PO.</p> <p>Kazakhstan is a party to a number of bilateral and multilateral treaties for the provision of MLA. The bilateral treaties include agreements with China, Turkey, Lithuania (2002), North Korea, South Korea, Iran (1999), the Czech Republic on Cooperation on Terrorism and Organized Crime (1999), Uzbekistan (1998), a Protocol on the Cooperation on Organized Crime, Terror, Drugs and other Dangerous Crimes (1995) with Germany, A Protocol with Hungary on Organized Crime, Terror, Illicit Drugs and Psychotropic Substances (1996), and an Interagency agreement with the Prosecutor's Office in Italy regarding Anti-Mafia efforts. A Multilateral Convention been executed with other CIS countries: the Convention of Legal Assistance on Civil cases, Family and Criminal Matters (Minsk) Convention (1993). This convention provides for legal assistance in the areas of handing over of documents; carrying-out examinations, search, seizure; handing over exhibits, carrying-out expert examinations; carrying out interrogation of a suspect, defendant, victim, witness, expert; search for a person; carrying out criminal prosecutions, extradition of a person in order to institute criminal proceedings or to carry out a sentence .</p> <p>The Chisinau Convention was signed on October 7, 2002, but the Chisinau Convention has not yet been ratified. Article 66 of the Convention will be able to be used to provide the following types of legal assistance: development, delivery and handing over of documents; carrying-out examination, searches and seizures; handing</p>

over exhibits, carrying-out expert examinations; carrying-out interrogation of a suspect, defendant, victim, witness, expert, defendants' legal representative, presentation of subjects for identification, including with the use of video communication, video recording and other hardware; search for a person; carrying out operational and search activities within the framework of an investigated case, carrying out criminal prosecution, extradition of a person in order to institute criminal proceedings or to carry out a sentence; search and seizure of money and property, gained by illegal means, as well as proceeds from criminal activity.

Kazakhstan is also a signatory to the 1999 CIS Treaty on Combating Terrorism. Compulsory measures, such as production of records, search of persons or premises, seizure and obtaining evidence for investigations and prosecutions are covered by these treaties. Conditions, including dual criminality, apply.

For non-treaty requests, Chapter 55 of the Criminal Procedure Code sets forth several bases for denial, which include:

- reason to suspect an investigation or prosecution is to punish for religious, ideological, or political beliefs or nationality or race;
- conviction for the same crime; and
- the request is for investigation of an offense for which the individual is being prosecuted in Kazakhstan.

With respect to procedures, Chapter 55 of the Criminal Procedure Code provides specific methods for dealing with requests. Incoming requests are sent to the PO's office in Astana, which serves as the Central Authority. As a matter of practice, where required, the requests generally go to the PO in the specific oblast in question. There are 15 oblasts in Kazakhstan, each which may provide international legal assistance, as required. If the request is a treaty request, the PO in the relevant oblast sends the information directly back to the Central Authority in the requesting country. If the request is not a treaty request, but subject to the provisions of the Criminal Procedure Code, the PO of the oblast sends the information back to the PO in Astana, who reviews the material and then forwards it back to the central authority in the requesting country.

Foreign confiscation orders, if issued after conviction in a foreign country, can be recognized and enforced, and assets frozen and confiscated in Kazakhstan. Foreign requests for freezing and seizing can be recognized at the initial discretion of the PO's office for foreign criminal proceeding on the basis of either a treaty or the provisions of Chapter 55 the Criminal Procedures Code where no treaty exists. Once the Prosecutor's Office has agreed to process the request, the matter is put before the courts in order to obtain a court order.

Use, Implementation, and Tracking of Requests (35, 37)

The formal requirements to enable Kazakhstan to cooperate internationally are laid out in Chapter 55 of the Criminal Procedure Code. Where there is no treaty, mutual assistance is provided on the basis of "reciprocity." The request must come from a foreign investigative agency or the court. The provisions delineate the form of the request and the various seals that are required before the authorities in Kazakhstan may assist the requesting party. Letters Rogatory are required for non-treaty requests. Officials at the PO's office strongly believe that it is easy for other jurisdictions to receive cooperation from Kazakhstan, although they admit that most requests are received from Russia with which they share a close relationship. Assistance to requests for legal assistance can be provided without a treaty and this assistance can include search and seizure or application of special powers like cross-border surveillance, and placing bugs at the discretion of the PO. For a list of treaties and conventions covering mutual legal assistance in criminal matters and extradition, see criterion 34 for a further description. Please see also criterion 36 for a list of the treaties, memorandum of understandings (MOUs), etc. with respect to ML and the confiscation of proceeds to which Kazakhstan is a party. See also discussion in criterion 42.

Use, Implementation, and Tracking of Requests

International cooperation in legal assistance is regulated by Chapter 55 of the Criminal Procedure Code. Under Article 521 of the Code requests for legal assistance can be provided without a treaty that is on the base of reciprocity. Even search and seizure or application of special powers like cross-border surveillance, placing

bugs etc. at discretion of a prosecutor can be provided. Generally, the requested legal assistance can be carried out if the same process could be exercised in a similar domestic case.

Kazakhstan is a party to the Minsk (1993) CIS Convention on Legal Assistance.

Within the framework of the Council of Minister of Interior of CIS states, there is a coordinating structure, namely the Bureau for Coordination of Fighting against Organized Crime. Cooperation encompasses, among other things, information exchange and carrying out joint investigations.

Cooperation in fighting terrorists is carried out within the framework of the Organization of Collective Security Treaty of which Kazakhstan is a party. The regional antiterrorist body of Shanghai Organization on Cooperation, of which Kazakhstan is also a party, started its operations in February 2004.

Kazakhstan has signed bilateral agreements with China covering mutual legal assistance in criminal matters and extradition with the following countries: Turkey; North and South Korea; Germany; Hungary; Lithuania; Iran; Czech Republic; and Uzbekistan.

The relevant measures, which can be taken in relation to legal assistance include:

- Acquisition of witness testimony and explanation,*
- Submission of judicial documents,*
- Inspection of places, areas of residence and other areas,*
- Submission of material, information or material evidence,*
- Presenting opinions of experts,*
- Submission of original or certified copies of documents, including bank and financial records*
- Identification of persons and their residence,*
- Search and seizure of property,*
- Identification of proceeds or property obtained in criminal ways as well as means used in the commission of crime, and*
- Performing operational investigations activities.*

Kazakhstan may reject a request for legal assistance on the following grounds:

- The request contradicts national interests,*
- The dual criminality principle is not met,*
- The other party can not commit itself not to apply capital punishment, or*
- The person in question is convicted in Kazakhstan.*

The Prosecutor General's Office keeps statistics on the number of requests for providing legal assistance. In 2003, 381 requests were received, 350 satisfied, 32 requests were rejected for legal and technical reasons.

In the same year, Kazakhstan filed with other jurisdictions 537 requests for providing legal assistance, 144 of which were satisfied, none rejected. Russia and Kazakhstan cooperation, for instance, favors the highest rate of exchange of requests for legal assistance.

The Agency for the Fight Against Economic and Corruption Crimes provided statistics on international information requests and requests for international legal assistance. In 2003, 164 foreign requests (of both kinds) were received, 162 satisfied. In the same year, 459 requests were filed with other jurisdictions, including 384 with Russia, 27 from Interpol, 16 from the Kyrgyz Republic, 13 from Uzbekistan, 6 from Tajikistan, 7 from Ukraine, 4 from Latvia, and 2 from Belarus. In total, 174 were satisfied.

The Agency of Customs Control does not keep statistics on requests that are made or received.

Kazakhstan authorities were reluctant to provide data on length of time for requests. They just indicated that the requests were processed "without delays."

Extradition (40, 36)

In Kazakhstan, extradition of non Kazakhstani nationals may take place pursuant to a treaty or pursuant to Chapter 55 of the Criminal Procedures Code. Kazakhstan may therefore extradite in absence of a treaty but it will only extradite non-nationals in this instance. Kazakhstan has also concluded bilateral extradition treaties with Uzbekistan, Kyrgyzstan, and China. Kazakhstan is also a party to the Minsk multilateral treaty which includes extradition provisions. The Chisinau Convention was signed on October 7, 2002, but the Chisinau Convention has not yet been ratified. The Chisinau treaty extends the circumstances in which extradition may occur between the former CIS countries.

For the bilateral treaties, the treaties generally require dual criminality and all refuse to extradite Kazakhstani nationals as this would be in breach of Article 11 of the Constitution. Most treaties cover money laundering, although some older treaties, which adopted the list approach, have not been updated and may not cover the offense of ML. The PO will advise on this specifically at a later date.

Kazakhstan will not extradite its own nationals unless expressly agreed to under a treaty and no bilateral treaties currently so allow. The PO's office was unclear as to whether prosecutors in Kazakhstan could prosecute Kazakhstan nationals, who commit crimes outside of Kazakhstan, if the underlying conduct is also criminal in Kazakhstan but felt that, in theory, they could. There are no cases on this point. For an FT offense, as it exists in the law of Kazakhstan, defendants could be prosecuted in Kazakhstan, if the suspect is found in Kazakhstan. Kazakhstan would try to extradite defendants to Kazakhstan for trial if a terrorist attack in Kazakhstan by a defendant who was a foreign national, escaped to another country and the victims had Kazakhstan nationality. No cases on this exist, and it was unclear that other cases of FT or ML would be treated this way.

In case there is no relevant agreement between Kazakhstan and the requesting foreign country concerning the extradition of a charged person, provisions of the Article 521 of the Criminal Procedure Code are being applied.

Under Article 532 of the Criminal Procedure Code, the Prosecutor General of the Republic of Kazakhstan shall review the issue of extradition of a person based on a request by a foreign state and adopt a reasoned decision concerning this issue. Under Article 532 of the Criminal Procedure Code, extradition can only be exercised in case of dual criminality. If this rule is satisfied any crime can form the basis of an extradition order. Kazakhstani citizens cannot be extradited to a foreign state unless such an extradition is provided for by an international agreement.

In 2003, the Prosecutor's Office received 172 requests for extraditions, of which 150 were satisfied. The reason for failure to satisfy 17 requests was caused by Kazakhstan nationality of persons requested and dual criminality principle non-compliance.

Law Enforcement Exchange of Information (37)

Kazakhstan is a member of the Interpol. Diplomatic channels are also used to exchange information. Law enforcement also uses a number of attachés in various countries for its work.

Cooperative Investigations (38)

Under the law and practice in Kazakhstan, cooperative investigations with foreign authorities, including use of controlled delivery, may be authorized by a public prosecutor under the Criminal Procedure Code and the Law on the Prosecutor's Office. In certain cases of controlled delivery, two customs authorities could make their own arrangements without the need for the involvement of the PO. Bilateral cooperation regarding placement of listening devices, telephone interception, bugging, and cross-border surveillance may occur with the assistance of the PO and in strict compliance with the Criminal Procedures Code. Dual criminality is required for all requests. Requests may be made by treaty countries and non-treaty countries.

Co-coordinating seizure and forfeiture actions, sharing (39)

The mechanism of sharing assets of confiscated property with other states is not anticipated in Kazakhstani legislation. Asset sharing could be enforced through relevant international agreements only. There seem to be no asset sharing provisions in bilateral treaties where Kazakhstan is a party.

However, Kazakhstan authorities do have power to fulfill requests for assistance from foreign authorities related to restitution of property confiscated in the territory of Kazakhstan, even without relevant international agreement (this means that the request can be satisfied on the base of reciprocity).

Until now, there has been no consideration given to the establishing of an asset forfeiture fund. There is no place for off-budget funds in Kazakhstan government budget system. See also the description on criterion 35.

No Terrorist Safe-harbor (41)

Under Decree of the President of the Republic of Kazakhstan of July 15, 1996 no. 3057 "On Procedure of granting political asylum to foreign citizens and persons without citizenship in the Republic of Kazakhstan (with amendments made through Decree of the President of the Republic of Kazakhstan of April 19, 2000 no. 374), political asylum cannot be granted if the person:

- is prosecuted for commissions (or omissions) considered to be a crime under the law of the Republic of Kazakhstan or is guilty in committing acts that contradict the principles and objectives of the United Nations,*
- is brought to account for criminal offense or is under court conviction entered into force in the territory of the Republic of Kazakhstan,*
- was a resident of a jurisdiction where there was no threat of prosecution,*
- has given deliberately false evidence, or*
- is a citizen of a third state where it is not prosecuted.*

Under the Law of the Republic of Kazakhstan of December 20, 1991 no. 1017-XII "On the Citizenship in the Republic of Kazakhstan" (with amendments made through Decree of the President of the Republic the Republic of Kazakhstan of October 3, 1995, Law of the Republic of Kazakhstan of May 15, 2002 no. 322-II) application for the citizenship of Kazakhstan is rejected if the applicant, in particular:

- is involved in illicit activities, undermining state security and health of the population,*
- has been convicted for terrorist activity, or*
- has committed an outrage upon humanity.*

Under the Law of the Republic of Kazakhstan of December 13, 1997 no. 204-I "On migration of the population" (with amendments made through Laws of the Republic of Kazakhstan of March 1, 2001 no. 160-II, of December 10, 2001 no. 255-II, of December 24, 2001 no. 276-II, of March 27, 2002 no. 313-II) the foreign citizen or a person without citizenship can be rejected to enter territory of the Republic of Kazakhstan:

- if the individual has committed a crime against peace and security or humanity,*
- has been convicted for terrorist activity, or for earlier committed grave/particularly grave crime,*
- has provided false personal data or has not produced all necessary documents, or*
- has offended customs, currency or other legislation during his previous stay on the territory of the Republic of Kazakhstan.*

Financial, human or technical resources (42)

The authorities advised the mission that they had enough persons to handle requests for information "in an expedient manner." The FP indicated that for 2003, the number of inbound requests was 164, of which 162 were completed. No time frames were given. The number of outbound requests was 459 of which only 174 were fulfilled.

Analysis of Effectiveness
<p>Kazakhstan has a limited set of bilateral and multilateral treaties for providing MLA and extradition. Most treaties have been signed since 1995. The geographic scope of such treaties is limited mainly to the former CIS countries and a few other jurisdictions. There are no bilateral agreements with countries from western Europe or North America, although there are cross border financial dealings and resulting requests for assistance with both areas. In the absence of such treaties, it may provide assistance for both mutual legal assistance and extradition (of non nationals only) pursuant to Chapter 55 of the Criminal Procedures Code and the discretion of the PO.</p> <p>Articles 523 and 525 of Chapter 55 of the Criminal Procedure Code require Letters Rogatory for non-treaty countries. This effectively limits the timely provision of mutual legal assistance to those countries with which Kazakhstan has a bilateral treaty, or where the prosecutor is part of the judiciary. Only in very rare circumstances will the prosecutor’s office be a competent judicial authority, and thus most countries will be required to use Letters Rogatory, a process which at best is slow and cumbersome because it must be processed through diplomatic channels. Such reliance on Letters Rogatory ensures that neither expeditious nor effective cooperation can be given in ML investigations and prosecutions.</p> <p>The applicable MLA treaties enable authorities in Kazakhstan to provide assistance that involves compulsion, e.g. production of records, search of premises, or seizure of evidence. Assistance pursuant to letters rogatory is also available. The assistance requested, e.g. the production of bank records, is executed according to domestic law, which provides an adequate basis for securing such records. Mutual assistance, however, is not hampered by bank secrecy, as the PO can pierce bank secrecy with a signed and stamped resolution.</p> <p>The extradition of nationals of Kazakhstan is prohibited absent an agreement under treaty. All bilateral treaties ban the extradition of Kazakhstani nationals as it is contrary to Article 11 of the Constitution of Kazakhstan. Non nationals may be extradited.</p> <p>Regarding a foreign confiscation request, this could only be commenced with a foreign conviction order. Foreign requests for freezing and seizing can be considered by the PO but require Letters Rogatory to commence the process. In such cases, the PO would review the request, and if in its discretion it was decided there was a case under the law of Kazakhstan, the PO would sign and stamp a resolution and a financial investigation would commence and the matter would essentially be translated into the Kazakhstani system for addressing freezing and seizing. Dual criminality is therefore required. Confiscation would only be possible when a foreign conviction order was received. While Kazakhstan authorities may take only those measures in support of the foreign request that could be taken if they were confiscating or seizing in a domestic case, the wide range of powers and measures in the Kazakhstan system and the fact that the measures are available for all serious crimes means that there should be an ability to assist with most requests.</p> <p><i>Kazakhstan has in place a developed system of international cooperation so long as there is a bilateral or multilateral treaty. Non-treaty based requests are hampered by the formalized, lengthy and discretionary nature of the letters rogatory. Additionally, the dual criminality principle sets certain limits international cooperation.</i></p>
Recommendations and Comments
<p>Enact appropriate laws and procedures to provide the widest possible range of mutual legal assistance in AML/CFT matters in a timely fashion. Kazakhstan should also consider additional provisions on mutual assistance, which would allow it to give such assistance on a case-by-case basis without the need for a bilateral or multilateral treaty and without the need for the formalized and lengthy “Letters Rogatory” process.</p> <p>Kazakhstan should consider increasing the number of bilateral treaties, particularly with western European countries and with North America as these countries have been making a number of requests to Kazakhstan.</p> <p><i>The statistics on requests could be improved. Such date should include data on length of time for requests and be made obligatory to all law enforcement agencies involved in international cooperation. There seems not to be legal or institutional obstacles for coordinating seizure actions with other countries. Coordinating forfeiture actions could present a problem in Kazakhstan because forfeiture (confiscation) can be enforced through</i></p>

<i>decision of the court only.</i>
<i>There seems to be no asset sharing provisions in bilateral and multilateral treaties where Kazakhstan is a party.</i>
Implications for compliance with FATF Recommendations 3, 32, 33, 34, 37, 38, 40, SR I, SR V
FATF 3: Materially Non-Compliant: Letters Rogatory needed for non treaty bilateral requests which are slow and will not be effective in freezing and seizing property or funds.
FATF 32: Non-Compliant: no requirement to report suspicious transactions.
FATF 33: Not Rated.
FATF 34: Largely Compliant: Further bilateral and multilateral treaties should be signed.
FATF 37: Materially Non Compliant: Provisions are available at the discretion of the PO only and may therefore not be evenly applied in all cases. Letters Rogatory required for non treaty countries.
FATF 38: Materially Non Compliant: Cooperative investigations rarely undertaken
FATF 40: Largely Compliant: No provision to extradite own nationals and unlikely that authorities in Kazakhstan would take a criminal trial in Kazakhstan based on a foreign request.
SR I: Materially Non Compliant: ICSFT not fully implemented regarding FT.
SR V: Materially Non Compliant: ICSFT not fully implemented regarding FT.

Table 4. Detailed Assessment of the Legal and Institutional Framework for Financial Institutions and Its Effective Implementation

I—General Framework (compliance with criteria 43 and 44)
Description
<p>Law No. 474-11 on Government Regulation and Supervision of the Financial Market and Financial Organizations (July 4, 2003), together with Presidential Decree No. 1270 (December 31, 2003) on Further Improvement of the Government Administration System of the Republic of Kazakhstan establish the Agency for the Regulation and Supervision of the Financial Market and Financial Institutions (FSA), which carries out supervision of the banking, insurance, and securities sectors. In Kazakhstan, the banking sector is far more developed than the insurance or securities sectors, both in terms of regulatory structures and market activity.</p> <p>At the time of this assessment (February 2004), Kazakhstan had not adopted an AML/CFT law. However, it is evident that the FSA will be the natural authority for supervision and enforcement of AML/CFT provisions and obligations for the banking, insurance and securities sectors when such provisions come into force.</p> <p>The FSA is an independent regulatory agency accountable to the President of Kazakhstan, and has authority to supervise, regulate, and monitor activities of banking, insurance, and securities entities, issue prudential and disclosure regulations, grant and revoke licenses, audit compliance with these regulations and penalize non-compliance. Since the FSA came into existence on January 1, 2004, it subsumes this authority from the NBK, which formerly supervised these financial institutions. The laws and regulations applicable to these financial sectors has not changed and thus, banks remain subject to obligations of the Banking Law (No. 2444 on Banks and Banking, August 31, 1995, as amended), insurance companies to the Insurance Law (No. 126 - II on Insurance Activities, December 18, 2000, as amended), and the securities sector pursuant to the existing Securities Law (No. 461-II on Securities Markets, July 2, 2003, as amended).</p> <p>The FSA licensing department is made up of professionals with specific expertise in banking, insurance, and securities sector licensing. It has a licensing committee called the “Qualification Committee,” which grants licenses according to the provisions of licensing laws in each of these sectors. In addition, the Qualification Committee conducts personal interviews with potential licensees to determine their character, reputation, knowledge, and experience in the relevant sector. Licensing requirements are unique to each sector and are found in the law relevant to each sector.</p>

Insurance

The Insurance law, Law No. 126-II, December 18, 2000 on Insurance Activities, as amended, applies to all insurance activities. Insurance is a very new industry, and although the Insurance Law was enacted in 2000, only more recent (2002) amendments to this law set forth the appropriate legal basis for insurance companies to viably operate. To date, there are only 34 licensed insurance companies and a total of 6 brokers. As penetration of the market is below one percent of the market, this level of insurance activity is not likely to be attractive for money launderers.¹⁹ The FSA currently has approximately 27 insurance specialists supervising insurance activities in Kazakhstan.²⁰

Securities

The Securities Law, No. 461-II, July 2, 2003 on the Securities Market, regulates securities activities in Kazakhstan. The securities sector in Kazakhstan is at this time very small. In 2002, total turnover of securities on the Kazakhstan Stock Exchange (KASE) was US\$24,643,400 and preliminary statistics on 2003 indicate there was little increase, but that the securities market remains relatively illiquid.²¹ This indicates that the securities market, to date, remains a rather unattractive mechanism for money laundering.

Bank Secrecy

Banking secrecy provisions are contained in Article 50 (3) of Law No. 2444 on Banks and Banking in the Republic of Kazakhstan, of August 31, 1995, as amended (Banking Law). This provision imposes criminal liability for improper disclosure of confidential financial information, and exceptions to this provision are rather narrow and strictly drawn. Disclosure of any information, even the existence of an account holder, is only permitted to tax authorities, upon an order of a Prosecutor in connection with a criminal case, on the basis of a Court order, or to Customs authorities in relation to import/export transactions. As no other exceptions exist in law or regulation, any other disclosure of confidential information, even pursuant to a strong suspicion of criminal activity, could be subject to criminal liability. Thus, if bankers, or even officials in the NBK (including staff which are in positions where illegal transactions can be obvious to them, like the Currency Control Department), discover rather apparent signs of criminal activity, reporting such information to law enforcement authorities would violate banking secrecy provisions and subject such individuals to criminal prosecution.

Although Article 15 of the FSA Law authorizes the FSA to cooperate with authorized bodies of other governmental bodies of the Republic of Kazakhstan and bodies of foreign governments in the performance of regulating and supervising the financial market and financial organizations, there are no specific provisions which authorize the sharing of information with counterpart financial sector supervisory bodies abroad. Article 14 of this law imposes liability upon the FSA for disclosure of confidential or privileged information received in the course of supervisory and regulatory activities. This, together with the strict bank secrecy provisions, severely inhibits the ability of the FSA to share information with counterpart supervisory bodies abroad.

Analysis of Effectiveness

Although the FSA is the designated authority for consolidated supervision and regulation of the banking, insurance, and securities sectors, as a new agency, it has not yet audited or penalized any entities for non-compliance with laws or regulations it is responsible for enforcing. The FSA is also authorized to license these entities (including revoke and/or deny licenses) as well as issue and enforce prudential regulations, and regulations on disclosure, internal controls, and other similar requirements, as well as penalize non-compliance with mandatory obligations. Although it appears that the FSA is staffed with experts, who have reasonable expertise in their respective fields, it is too early to assess its supervisory effectiveness.

Bank Secrecy

The bank secrecy provisions of the Banking law act as a near-complete shield in protecting money launderers and their activities from detection by law enforcement authorities. The only circumstances in which a bank, or even bank

¹⁹ In 2003, the figure was 0.66 percent market penetration with a population of about 15 million.

²⁰ Excluding those who deal with licensing, strategy/analysis, and consumer protection issues.

²¹ Of which 74 percent was repos of government bonds.

<p>supervisory officials could inform law enforcement authorities of suspected criminal activity would be if the activity involved a clear violation of other banking laws or regulations, for example the Currency Control Laws. In effect, such bank secrecy provisions legally obligate bankers and financial sector supervisory officials to turn a blind eye to highly suspicious criminal activity. In view of the fact there are no “safe harbor” provisions, which would protect bankers or officials from penalties or criminal prosecution from reporting suspected criminal activities to authorities, the banking secrecy provisions of the Banking Law are wholly incompatible with FATF Recommendation no. 2.</p>
<p>Recommendations and Comments</p> <p>As a modern integrated financial sector supervisory body, the FSA, has been created to supervise and enforce legal and regulatory obligations relevant to financial sector entities. It is clearly organized in a manner to be the best authority to implement AML/CFT obligations in the financial sector once an AML/CFT law has been enacted. An AML/CFT law, which meets international standards, should be expeditiously enacted to address the AML/CFT risks in Kazakhstan due to its geographic location in the region and its booming economy.</p> <p>The banking secrecy provisions in the Banking Law are based on an archaic concept of bank secrecy, which virtually shields obvious instances of money laundering from detection by authorities. Exceptions to these non-disclosure provisions should allow supervisory officials and bank staff to report suspected instances of criminal activity (including relevant financial and account information which supports the suspicion) to authorized law enforcement authorities without the possibility of criminal prosecution. In addition, an AML/CFT law should legally obligate such reporting of suspicious transactions, and penalize non-compliance with this obligation.</p>
<p>Implications for compliance with FATF Recommendation 2</p>
<p>FATF Recommendation 2: Non-compliant.</p>
<p><i>II—Customer identification</i> (compliance with criteria 45-48 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 68-83 for the banking sector, criteria 101-104 for the insurance sector and criterion 111 for the securities sector)</p>
<p>Description</p>
<p>Banking</p> <p>NBK Regulation no. 266 (June 2, 2000, as amended) on Account Opening Documentation sets forth obligations of banks with respect to the opening of accounts. For individual accounts, it requires authorized signature, tax registration certificate, and state registration form for entrepreneurs, legally recognized identification card. Required account opening documentation for legal entities includes: charter, authorized signatures, seal of the entity, tax identity form confirming the registration of the client for tax accounting purpose, statistical card, and state registration certification. As this documentation is required for all accounts, anonymous accounts are not permitted. This regulation allows for opening of accounts by third parties with notarized powers of attorney, and tax registration certification.</p> <p>NBK Regulation no. 434 (December 6, 2003, as amended) requires all banks to regularly evaluate reputation, business image, and credit risks of their clients.</p> <p>NBK Regulation no. 179 (April 25, 2000, as amended) on Payment Documents and Effecting Non-Cash Payments and Remittances, requires full names of a person or legal entity be used to execute payments, along with a notation of the purpose of the payment and personal identity code.</p> <p>NBK Regulation no. 395 (October 13, 2000, as amended) on Effecting Non-Cash Payments and Remittances permits execution of bank transactions without having or opening an account with the bank, however, such transactions require identity documents which include: full name and legal/juridical form of the payor, as well as an individual identification number. If no individual identification number is available, the address of the payor is required. For juridical persons (entities), it is also required to provide full name of the entity, authorized signer, and a copy of the corporate seal.</p>

Insurance

There are no formal know-your-customer documentation regulations or requirements for insurance companies or insurance brokers. Pursuant to the insurance law, insurance contracts must be carried out on the basis of a contract the execution of which requires personal identity details as well as the tax identification number. No legal obligation exists for an insurance company or broker to ensure the funds paid to purchase the policy or premium payments originate from legal sources.

Securities

Article 44 of Law No. 461-II of July 2, 2003, on the Securities Markets (Securities Law) requires market professionals and intermediaries to execute written contracts with clients before providing securities services. Additionally, related regulations require that the FSA shall approve the form of such contract, which must contain a tax identity number. Presently, there is no legal obligation for market professionals or intermediaries to conduct customer identity checks or require further documentation on the client, any beneficial owners, document the investment objectives of the clients, or document the source of the funds invested.

Under recent amendments to the Securities Law, which took effect in January 2004, the Central Securities Depository is the authorized body that maintains the official list of holders of securities. To date, 99 percent of stock exchange settlements are done by the CSD. In the very near future, the CSD will be authorized to open broker accounts (both trading accounts and cash accounts), as well as sub-accounts of clients of brokers. Presently, the CSD is not obligated to carry out know-your-customer procedures; however, it requires proof of a broker's license before opening an account of any broker. Brokers are licensed by the FSA's Qualification Commission, which conducts a verification of qualifications as well as certification of no prior criminal record before issuance of a broker's license.

Terrorist Financing

The NBK has issued an order to all banks, insurance companies/brokers and securities market participants requesting that all existing accounts and all new accounts be reviewed against the terrorist lists issued by the United Nations and the United States. These updated lists are circulated to these entities on a regular basis.

Analysis of Effectiveness

Banking

The above-mentioned banking regulations set forth various documentary requirements for opening accounts and executing transactions, as well as requirements for regular review of the client's identity and business. Although these requirements set forth certain documentation with respect to identity verification of the customer, they are insufficient with respect to obligating the bank and/or bank staff to sufficiently "know" the customer, the purpose of the transactions, or the client's business in order to sufficiently determine whether the transaction/s is/are suspicious. NBK Regulation no. 395 permits execution of payments by non-account holders upon production of certain identity documentation, but no requirement that evidence be provided with respect to the purpose of the transaction. Although the NBK Regulation no. 266 on Account Opening Documentation, requires a certain level of know-your-customer documentation for clients of a bank, bank transactions executed by nonaccount holders represent much higher risk, and thus, the level of documentation and information a bank should be required to obtain prior to execution of such transactions should be significantly higher, and should require documentation concerning the purpose of the payment.

The customer identification documentation requirements in the NBK Regulations on Account Opening do not permit anonymous or numbered accounts, and require official documentation, which verifies the identity of the person. For customers who fall into lower risk client categories, this documentation may be sufficient. However, there is no requirement that bankers require additional information from clients, which might be categorized as higher risk, to enable bankers to satisfy themselves that the origin of the client's funds are from legitimate sources.

The know-your-customer documentation required for nonaccount holders is found in the NBK regulation on Payment Transfers, which requires a lower level of customer identity documentation than for regular account holders. Transactions by nonaccount holders should require a higher level of customer identification requirements and higher standards of proof that the funds being transferred are not related to illegal activities because such transactions can be riskier in nature than those of the bank's regular clients. Therefore, a bank should be required to obtain additional information and documentation about the source of these funds and purpose of the payment regardless of the amount.

Since money launderers and terrorists are experts in providing legitimate documentation to meet such minimum standards, an AML/CFT law should obligate banks and other entities to be proactive in utilizing reasonable professional judgment and discretion to demand additional documentation (beyond those stipulated in the laws and regulations) or other evidence to become satisfied that a client is not engaged in criminal activities, and that the funds deposited or transferred originate from legal activities. This obligation should also be implemented in the Banking Law and relevant regulations promulgated in FSA regulations for banks.

In Kazakhstan, some (but not all) of the largest banks (both foreign and local) have voluntarily implemented AML/CFT policies and procedures, as they prefer to choose their clients and are very concerned with the quality of their public reputation. However, all banks are subject to the FSA documentary regulations on account opening and internal controls, which are audited by the FSA. These regulations contain documentary requirements which include official identity documentation as well as a taxpayer identification number. Although these requirements are an important part of the customer identification process, they stop short of requiring that banks obtain further documentation concerning a customer's business activities and other information which would enable a bank to be reasonably certain that the funds traversing the accounts of the bank are derived from legal sources.

Insurance

Although there do not yet exist formal know-your-customer documentation requirements for insurance companies or insurance brokers, a certain level of customer identity documentation is required due to the fact that insurance activity must be carried out on the basis of a contract. This requires provision of certain identity documentation as well as tax identity number, which are important documents. However, an AML/CFT law should require insurance companies and brokers to obtain sufficient evidence and information from each customer to be reasonably certain of the identity of the customer, and the identity of the beneficiary of the insurance contract, as well as the fact that the funds paid in premiums are reasonably certain to originate from lawful activities.

In Kazakhstan, the insurance sector is still relatively small which, at this time, makes it rather unattractive for money laundering. If large amounts of money suddenly were being laundered through insurance products at this time, it most likely would spark the attention of FSA supervisors. Nevertheless, it is important to implement know-your-customer requirements in the short-term, as the Kazakhstani economy is growing rapidly and the insurance sector could easily become a convenient mechanism for money launderers to launder proceeds from illegal activities.

Securities

The modest turnover of shares traded on the stock exchange makes the securities sector rather unattractive for money launderers. However, as the Kazakhstani economy is growing at a relatively rapid rate, securities can, in the relatively near future become a convenient mechanism for money laundering. Since there currently exists no legal obligation for brokers or other market professionals/participants to conduct know-your-customer policies, it is important that this requirement be adopted in relevant laws and regulations, as well as the general obligation that market participants obtain further documentation and other relevant information to be reasonably satisfied that they know the beneficial owner of the account and that the funds used in securities transactions originate from legal sources.

Terrorist Financing

The voluntary use of the UN and US Terrorist Lists are useful to prevent terrorists from utilizing the financial system. However, the Order issued by the FSA to banks requesting review of clients against such lists is not yet an enforceable obligation, thus, no penalties can be imposed for non-compliance until it becomes a mandatory obligation. The use of these lists to screen existing and potential customers is not audited. Additionally, it is unclear what a bank should do upon discovering a client's name on a terrorist list. If the bank secrecy provisions prevent the bank from informing the FSA or the Prosecutor of the existence of such account, even the voluntary obligation to screen clients against such lists has little purpose or effect.

Recommendations and Comments

An AML/CFT law should obligate designated entities to use professional discretion and judgment in assessing the potential risks that certain clients may be engaged in criminal or terrorist activities. In addition, relevant regulations should stipulate that the documentary requirements for account opening and executing payment transactions is the minimum standard required in all client relations. Regulations should be elaborated to ensure that all entities covered by AML/CFT obligations are required to conduct regular risk assessments of general categories of industries, clients, and politically exposed persons for the purpose of implementing additional know-your-customer documentation (and other information) requirements for those client groups, which present higher risks for money laundering or terrorist financing.

There is no requirement to give attention or heightened customer due diligence to payments made by wire transfers by individuals, or charitable organizations in respect of terrorist financing, except that banks have been asked to voluntarily screen customers/clients against the US and UN Terrorist lists. These screenings should be mandatory and audited for non-compliance. The Republic of Kazakhstan should compile its own list of terrorists, which may operate in Kazakhstan or in the region of Central Asia, whose names may not always be on the UN or US lists.

Implications for compliance with FATF Recommendations 10, 11, SR VII

FATF Recommendation 10: Largely compliant.

FATF Recommendation 11: Materially non-compliant.

SR. VII: Not Rated: FATF requirement allows for implementation by 2005.

III—Ongoing monitoring of accounts and transactions

(compliance with Criteria 49-51 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 84-87 for the banking sector, and criterion 104 for the insurance sector)

Description

Banking

Currently, an AML/CFT law does not exist, and there are no specific provisions in a Banking Law concerning ongoing monitoring of accounts or transactions to identify or report suspicious transactions. However, Article 24 of the NBK Regulation on Internal Controls (No. 112, June 5, 1998, as amended), requires Bank employees to “observe legislative requirements related to prevention of legalization of illegally obtained income.” Although there currently exist no legislative requirements concerning money laundering, this Regulation requires banks to establish an Internal Control unit in the bank and report the following to that Internal Control Unit:

1. any receipts (deposits, loans, acquisitions of the bank’s securities) by the bank of amounts exceeding T 5 million without evidence of the source of the funds;
2. any cash transactions for amounts exceeding T 1 million;
3. speculative operations with corporate securities;
4. transfer or sale of the right to claim a financial tool without any documented justification; and
5. other operations and transactions deemed suspicious.

NBK Regulation No. 115, April 20, 2001 on Currency Transactions (as amended) requires that banks obtain documentation from clients concerning the purpose of payment from individuals executing transactions exceeding US\$10,000. This regulation also requires that when natural persons execute transactions which, in one month total more than US\$50,000, the bank must report such transactions to the NBK within 3 working days following the end of the calendar month.

Insurance

There are no specific requirements applicable to insurance companies or agents with respect to transaction monitoring. However, the above-cited NBK Currency regulation also applies to insurance companies and brokers.

Securities

There are no specific laws or regulations that require securities companies or market professionals to monitor transactions for suspicious activity. However, the above-cited NBK Currency Regulation also applies to securities market participants. In addition, broker/dealers are generally not licensed to accept cash payments for securities transactions, and thus, such payments must be made via bank accounts. Although the Central Securities Depository has been recently authorized to accept broker accounts and cash accounts due to recent amendments to the Law on the Securities Markets, it is not authorized pursuant to Article 80 to accept cash payments, thus all incoming and outgoing payment transfers must be made via bank accounts.

Analysis of Effectiveness

Banking

Although Article 24 of the NBK Regulation on Internal Controls, which requires bank employees to “observe legislative requirements concerning,” there is no legislation on prevention of money laundering, nor any requirements to report suspicious transactions to authorities. This section of the NBK Regulation is rather ineffective, as it merely requires bank staff to report suspicious transactions to the banks own internal control unit, and not to appropriate authorities with responsibility for taking steps with respect to prevention and detection of money laundering or terrorist financing. Further, reporting such information to an authorized body would clearly constitute a criminal violation of banking secrecy provisions of the law on banking.

Although NBK Regulation No. 115, April 20, 2001 on Currency Transactions (as amended) requires that banks obtain client documentation justifying the reasons for the transaction from individuals for transactions US\$10,000, in the event the required client documentation isn't available, the transaction can still be executed upon approval of the NBK.

The provision of this regulation which requires banks to report transactions of a single client, which in one month total more than US\$50,000, is clearly intended to identify large cash transactions which might indicate criminal activity. However, such reports are not required to be made in a timely manner; rather this regulation requires such report to be made within three days after the end of a calendar month. If a criminal executed transactions totaling more than US\$50,000 on the first day of a calendar month, the transaction need not be reported to the NBK for about 25 full days, which is enough time for a money launderer to dispose of the proceeds, and ensure that authorities cannot easily freeze or trace the funds. Additionally, even though transactions above US\$50,000 should be reported to the NBK, there is no authority that permits the NBK to report such transactions, if suspicious, to any governmental body with authority to take action in respect of prevention or detection of money laundering or terrorist financing. Also, the regulation applies only to payments executed by individuals and not by legal persons.

A cash or transaction reporting threshold for purposes of prevention and detection of money laundering is an arbitrary limit which should be established for each country based on their own economic circumstances. There are no specific rules or international standards, which provide guidance on what level such thresholds should be established. However, most western countries establish the limit at around US\$10,000 to US\$15,000 (equivalent). Thus, a threshold of US\$50,000 for Kazakhstan may be rather high and would allow a lot of transactions, which could involve money laundering or terrorist financing to go unreported.

Insurance

Although the insurance industry may currently not be an attractive sector through which money launderers would be tempted to launder illegal proceeds, as the industry grows, it may become more attractive to money launderers, and thus, legal obligations contained in an AML/CFT law, the insurance law and relevant regulations would be needed to prevent and detect money laundering in the insurance sector. Such obligations should be made applicable to insurance companies, re-insurance companies, as well as insurance brokers. The above-cited NBK regulation, which requires obtaining purpose of payment documentation for transactions of individuals above US\$10,000 (equivalent) and report transactions above US\$50,000 to the NBK applies to insurance companies and brokers, but it does not apply to transactions executed by legal entities.

Securities

Although the securities industry may currently not be an attractive sector through which money launderers would be tempted to launder illegal proceeds, as the industry grows, it may become more attractive to money launderers, and thus, legal obligations contained in an AML/CFT law, the Securities Market Law and relevant regulations would be needed to prevent and detect money laundering in this sector. Such obligations should expressly be made obligatory upon all market participants, including broker-dealers, as well as the stock exchange and the Central Securities Depository. The above-cited NBK regulation which requires obtaining purpose of payment documentation for transactions of individuals above US\$10,000 (equivalent) and report transactions above US\$50,000 to the NBK applies to securities market participants, but does not apply to transactions executed by legal entities.

CFT
Although the NBK has issued to financial companies the UN and US Lists of Suspected Terrorists, and requested that financial entities screen current and prospective clients against it, this obligation is not mandatory, nor can non-compliance be penalized. In addition, there is no obligation to monitor suspicious transactions, with regard to potential for terrorist financing.
Recommendations and Comments
An AML/CFT Law should require all persons/entities it covers to implement policies and procedures for on-going monitoring of transactions and accounts to identify and report suspicious transactions. These procedures should require classification of customers and clients, and to apply higher and more frequent transaction monitoring procedures to clients/customers which represent higher risks for money laundering or terrorist financing to the institution. The AML/CFT law should include a “safe harbor” provision which protects those who report transactions in good faith from civil or criminal liability. Additionally, the level of the currency transaction reporting threshold should be reconsidered. Currency/cash transaction reports should be available to both the FIU and law enforcement. Internal policies and procedures in this regard should be in writing and approved by the entities highest levels of management, and the internal control unit of the entity should be obligated to conduct internal audits to detect and correct incidents of non-compliance. Additionally, compliance with such obligations should be audited for compliance by the FSA, and sufficient penalties for instances of non-compliance should be available.
Implications for compliance with FATF Recommendations 14, 21, 28, SR VIII
FATF Recommendation 14: Non-compliant. FATF Recommendation 21: Materially non-compliant. FATF Recommendation 28: Non-compliant. FATF S.R. VIII: Materially Non-compliant.
<i>IV—Record keeping</i> (compliance with Criteria 52-54 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 88 for the banking sector, criteria 106 and 107 for the insurance sector, and criterion 112 for the securities sector)
Description

Banking

NBK Regulation on Currency Control no. 343 (September 5, 2001) requires documents subject to currency controls to be maintained for a period of five years from the date of the execution of the transaction. In addition, this regulation requires records relating to foreign currency exchange transactions also to be maintained for a minimum of five years.

NBK Regulation no. 351 on Account Opening Documentation requires that all client documentation submitted with intent to establish an account (including requests, certificates, and copies of the corporate documents) concerning opening accounts shall be maintained for five years following the date the account is closed. In addition, this regulation requires documents related to the accounts of the juridical persons to be kept for five years, or longer if the records are related to ongoing audits by tax bodies.

Insurance

An exhaustive list of client and transaction documentation related to insurance transaction documentation is being issued by the FSA, which sets forth a long list of documentation and the required records maintenance requirements. According to this instruction, all documentation related to client transactions and client records is required to be maintained for a minimum of five years. As this regulation is undated and unnumbered, it is not yet a mandatory obligation.

Securities

Licenses are required to meet relevant IT and software requirements. Internal procedures of record keeping are subject to FSA approval, and subject to on-site supervision. A transaction confirmation system was adopted by the Stock Exchange to avoid market disruption. The Securities Law provides mandatory “mirror reflection” of transactions and accounts of market intermediaries—nominal holders (custodians and brokers) in the Central Securities Depository.

Analysis of Effectiveness

Although NBK Currency Control Regulations require maintaining documentation related to foreign currency transactions for five years, the maintenance requirement is not generally applicable to transaction documentation, which does not involve foreign currency transactions. The NBK Regulation on Account Opening Documentation requires that all client documentation be maintained for five years is appropriate.

Records maintenance requirements are important for prevention and deterrence of money laundering and/or terrorist financing, because records and documents of such transactions are generally the most important evidence available to prove that money laundering or terrorist financing has occurred. Without access to these records, it would be impossible for investigators and prosecutors to build a sufficient case to achieve conviction. Although records maintenance requirements apply to banks, such requirements should be obligatory for all persons and entities subject to the envisaged AML/CFT law.

The securities industry has systems for transaction records due to the fact that transactions are executed on the Stock Exchange and through the Central Securities Depository. However, securities companies and market participants should be obligated by law to maintain know your customer documentation and all transaction records for a minimum of five years after the date the relationship with the client ceases. These records should be easily accessible to the pertinent authorities.

Recommendations and Comments

An AML/CFT law, as well as relevant sectoral laws and regulations, should require that all persons and entities subject to it, maintain all transaction documents and client records for a minimum of five years. Such records should be maintained in a manner that they are easily searchable and available to relevant authorities that must have access to them.

Implications for compliance with FATF Recommendation 12

FATF Recommendation 12: Materially non-compliant.

<p><i>V—Suspicious transactions reporting</i> (compliance with Criteria 55-57 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 101-104 for the insurance sector)</p>
<p>Description</p> <p>In Kazakhstan, there exists no legal obligation for financial sector or other entities, professions, or individuals to report suspicious transactions to an authority authorized to detect and prevent money laundering or terrorist financing. There is also no safe harbor provision, which provides liability protection from those, who would choose to voluntarily report suspicious transactions. Under the bank secrecy provisions of the Banking Law, bankers or even officials of government agencies, who observe suspicious transaction activity and report it to authorities, could be held criminally liable. There are no legal prohibitions for tipping off, or penalties for tipping off those whose suspicious transaction activity may have been reported to authorities.</p> <p>Although there are no legal provisions, which require or permit reporting of suspicious transactions, the NBK Regulation on Internal Control requires bank staff, who encounters suspicious transaction activity to “observe” anti-money laundering legislation, and require that the information be reported to an Internal Control Unit in the bank, which is created to ensure internal compliance with all relevant laws and regulations applicable to banking activities. The FSA audits compliance with this requirement during its on-site inspections.</p> <p>An AML/CFT Law is in the process of being drafted in Kazakhstan. It is anticipated that this law will include the legal obligation for reporting suspicious transactions and the establishment of an FIU. However, this draft law is still in rather preliminary form and at the time of this mission has not been reviewed by all relevant ministries or government bodies, and thus has not yet been sent to the government or parliament.</p>
<p>Analysis of Effectiveness</p> <p>Lack of an AML/CFT Law that requires reporting of suspicious transactions to authorities that are authorized to prevent and detect money laundering and terrorist financing is one of the most important elements in fighting organized crime and terrorism. The NBK regulation, which requires banks to maintain internal records of suspicious transactions, is not sufficient, since it prevents this information from getting to authorities, who could act on such information. There are no provisions, which require insurance companies or securities market participants to record or report suspicious transactions.</p>
<p>Recommendations and Comments</p> <p>Enactment of an AML/CFT Law that meets international standards, including establishing an FIU, requiring the reporting of suspicious transaction to authorized authorities, amending the bank secrecy provisions of the Banking Law to allow for the reporting of suspicious transactions, and inclusion of prohibitions for tipping off, should be a high priority.</p>
<p>Implications for compliance with FATF Recommendations 15, 16, 17, 28</p> <p>FATF Recommendation 15: Non-compliant. FATF Recommendation 16: Non-compliant. FATF Recommendation 17: Non-compliant. FATF Recommendation 28: Non-compliant.</p>
<p><i>VI—Internal controls, Compliance and Audit</i> (compliance with Criteria 58-61 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 89-92 for the banking sector, criteria 109 and 110 for the insurance sector, and criterion 113 for the securities sector)</p>
<p>Description</p>

<p>Banking</p> <p>NBK Regulation on Internal Controls (Article 15) requires that banks establish an Internal Control Unit to implement policies and procedures, which ensure compliance with all relevant laws and regulations. This regulation requires that the Internal Control Unit conduct internal audits to ensure all policies and procedures are followed, including the requirements of the NBK regulation on Account Opening Documentation. The NBK Regulation on Internal Controls (Article 23) also requires bank staff to report suspicious transaction to the Internal Control Unit. Noncompliance with the NBK’s Internal Control Regulation is subject to a penalty.</p>
<p>Insurance</p> <p>The FSA is entitled to recall senior managers and reexamine certified specialists, who are in violation of laws or regulations.</p>
<p>Securities</p> <p>The FSA is entitled to recall senior managers and reexamine certified specialists, who are in violation of laws or regulations. A Code of Conduct (Ethics Code) of Market Intermediaries and Qualified Specialists was adopted for the industry, although it does not have the effect of law.</p>
<p>Analysis of Effectiveness</p> <p>There is no legal requirement for banking, insurance, or securities market participants to designate an AML/CFT Compliance Officer responsible for designing policies and procedures which prevent the institution from being used by money launderers, terrorists, or other criminals. There is no requirement to carry out staff training regarding AML/CFT compliance issues. There is also no requirement to have appropriate screening procedures in the hiring of bank staff to ensure high standards of hiring.</p> <p>The NBK Regulation on Internal Controls is not sufficient because an internal AML/CFT Compliance officer is not required as a function separate from the Internal Control Unit. The NBK Regulation on Account Opening Documentation is insufficient, as it falls short in obligating financial institutions to take effective action to understand the client, the clients business, and in making a reasonable assessment as to whether the funds of the client are from legitimate sources.</p> <p>The lack of a legal requirement to provide on-going training to staff impedes the ability of the staff to identify money laundering and terrorist financing, let alone new and innovative methods that criminals can use financial institutions as mechanisms of laundering.</p>
<p>Recommendations and Comments</p> <p>The function of AML/CFT Compliance Officer should be a separate function from the Internal Control/Audit function, as the effectiveness of compliance with AML/CFT obligations should be tested by persons other than those who designed and implemented them. The envisaged AML/CFT law and relevant sectoral laws and regulations should require financial institutions to formally designate an officer responsible for drafting and implementing internal AML/CFT compliance procedures as well as staff training. The requirements for designation of AML/CFT Compliance Officers and training should apply to all branches and subsidiaries.</p>
<p>Implications for compliance with the FATF Recommendations 19, 20</p> <p>FATF Recommendation 19: Materially Non-compliant. FATF Recommendation 20: Non-compliant.</p>
<p>VII—Integrity standards (compliance with Criteria 62 and 63 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criterion 114 for the securities sector)</p>
<p>Description</p> <p>The FSA is authorized to license banks, insurance companies, and professional participants in the securities markets pursuant to Article 9.3 of the FSA Law. The FSA makes licensing decisions based on the licensing requirements of the relevant Banking, Insurance, or Securities Market Law. The FSA’s Licensing Department is responsible for the granting and denying of licenses. It has a Qualification Committee, which makes licensing decisions. All</p>

documentation in application for the license should be submitted to the Qualification Committee, and a personal interview to determine the applicant's knowledge and experience.

Banking

The licensing provisions for bank licensing are set forth in Articles 19–23 of the Banking Law. In addition to documentary requirements, which include submission of a business plan for the bank, Article 20 of the Banking Law sets forth “fit and proper” requirements for executive officers and those who would own a major share of the bank. Fit and proper requirements include having requisite education and previous professional experience, as well as proof that the applicants do not have any outstanding criminal convictions. Foreign applicants of a banking license must submit proof that they possess a valid banking license in their home country jurisdiction. If any of the criteria is not met, the license application may be denied. Only one banking license has been granted since the year 2001.

Insurance

Licensing provisions for insurance companies and brokers are contained in Articles 37–39 of the Insurance Law. The FSA's Qualification Committee grants or denies insurance licenses. A “fit and proper” test is required with respect to educational experience and past professional experience. A personal interview is conducted by the Qualification Committee. Among the documentation required for an insurance license is a business plan. There is no requirement concerning providing evidence of a past criminal record, and Article 38 provides no grounds for refusal of an insurance license of an applicant, who has a past criminal record.

Securities

Securities licenses for brokers/dealers and investment companies are governed by Article 48 of the Law on the Securities Market. Applicants are required to have appropriate qualifying certifications evidencing appropriate professional experience in the securities industry. Applicant must provide an opinion of the self-regulating body on compliance of the applicant with all documentary requirements of the self-regulating body, and the applicant must produce evidence of sufficient training of persons, who will be executing securities transactions. There appear to be no grounds for denial of a license on grounds of past criminal activity. A Code of Conduct (Ethics Code) of Market Intermediaries and Qualified Specialists was adopted for the industry, although it does not have the effect of law.

Analysis of Effectiveness

The FSA's procedures for licensing pursuant to determinations made by the FSA's Qualification Committee are appropriate. However, it would be useful if the FSA tested the provided documents. Furthermore, as the FSA has only existed for several weeks to date, it is difficult to assess the actual effectiveness of these new licensing procedures.

The ability of the FSA to deny a license to an applicant is unduly restricted by the inability to deny a license on the grounds of past criminal activity. The Qualifications Committee can only deny a license of a criminal applicant who has been convicted, but have not yet fully served their sentence for the conviction. Once a criminal has fully served the sentence, no matter what the criminal conviction was for, and even if the applicant is under criminal investigation for financial crimes a license must be granted. It is also not grounds for license denial if foreign supervisory officials abroad produce information concerning criminal activity of an applicant, which has not resulted in a conviction.

As a result, it is not appear difficult for individuals with criminal pasts to gain control or a majority stake in a bank, insurance, or securities firm. Where reliable evidence that an applicant (individual or company) is suspected of being connected with criminal activity, particularly if financial crimes are concerned, the Qualifications Committee should be able to deny the license application. Similarly, if a person has been convicted and served his/her sentence for crimes involving financial or economic activity, theft, bribery, corruption, or other similar crimes, this should be sufficient justification for denial of a license for any financial sector activity.

Recommendations and Comments

Laws and regulations related to licensing financial sector entities should give the FSA legal authority to reject or deny license applications from applicants suspected of involvement in criminal activity, or with a past criminal

history connected to economic, financial, or related crimes, whether or not the full sentence has been served.
Implications for compliance with FATF Recommendation 29
FATF Recommendation 29: Largely compliant.
<i>VIII—Enforcement powers and sanctions</i> (compliance with Criteria 64 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 93-96 for the banking sector and criteria 115-117 for the securities sector)
Description
<p>Banking</p> <p>Article 47 of the Banking Law authorizes application of sanctions against banks and financial organizations for non-compliance with provisions of the Banking Law and relevant regulations. Sanctions include impositions of fines, suspending and/or revoking licenses, temporarily closing a bank, revoking the permit to open a bank, purchasing shares, relieving bank officials of their official duties, demanding the bank provide a group guarantee of deposits, and removal of the bank from the deposit insurance system, or conversion of the bank to a credit association.</p> <p>These sanctions can be applied by the authorized body, which has recently been re-defined by the law on the FSA, whose specific responsibilities regarding bank supervision are set forth in Article 10. Although the FSA is a newly created body, it is empowered to license, supervise, audit compliance of banks, and impose penalties in instances of non-compliance.</p> <p>Insurance</p> <p>Articles 53–61 of the Insurance Law set forth sanctions with respect to violations of the Insurance Law. The sanctions can be imposed against insurance companies, reinsurance companies, and brokers, and they include issuing compliance orders, imposing fines, license revocation or suspension, redemption of stock, and dismissal of officers from official duties.</p> <p>These sanctions can be applied by the authorized body, which has recently been re-defined as the FSA, whose specific responsibilities regarding insurance supervision are set forth in Article 11 of the FSA Law. Although the FSA is a newly created body, it is empowered to license, supervise, audit compliance of insurance companies and professionals, and impose penalties in instances of non-compliance.</p> <p>Securities</p> <p>Article 3 of the Law on Securities Markets states that the securities markets shall be regulated by the “Authorized Body,” which is defined in the FSA Law as the FSA, whose specific responsibilities for securities supervision are set forth in Article 12 of the FSA Law. Current legislation provides inspection, investigation, and surveillance powers of the FSA with respect to various professional market participants, stock exchanges, over-the-counter (OTC) trading systems, self-regulatory organizations (SROs), and issuers. In the case of non-compliance with legislative or regulatory obligations by market participants, the FSA is empowered to revoke licenses, impose penalties, recall approval of senior managers, and re-examine certified specialists. The FSA can refuse registration of a securities issue, suspend placement, and disapprove reports on placement and maturity. The FSA has the power to impose administrative sanctions (monetary penalties), or appeal to other government authorities to do so.</p>
Analysis of Effectiveness
It appears that the FSA will be the authority to enforce, audit, and penalize non-compliance of banks, insurance, and securities companies/professionals with AML/CFT law obligations. Although there exist some bank regulations concerning customer identification and reporting suspicious transactions to an Internal Audit unit within the bank (although not to authorities). No AML/CFT law yet exists, and these entities are not yet legally obligated to comply with effective requirements, which would prevent detection of money laundering or terrorist financing, including requirements, such as, know-your-customer, suspicious transactions, or cash transaction reporting, recordkeeping, or account monitoring obligations.
Recommendations and Comments

<p>An AML/CFT law should be enacted which sets forth effective requirements that would prevent and detect money laundering or terrorist financing. It should include provisions regarding know-your-customer, suspicious transactions, cash transaction reporting, recordkeeping, and account monitoring obligations. Additional amendments should be made to relevant laws and regulations, which require financial sector entities to implement the AML/CFT law obligations. The FSA should supervise compliance with these requirements, regularly audit compliance, and penalize instances of non-compliance.</p>
<p><i>IX—Cooperation between supervisors and other competent authorities</i> (compliance with Criteria 65-67 for the (i) banking sector; (ii) insurance sector; (iii) securities sector; and (iv) other financial institutions sector, plus sector specific criteria 97-100 for the banking sector and criteria 118-120 for the securities sector)</p>
<p>Description</p>
<p>Article 14 of the FSA Law empowers the FSA to obtain information from individuals and legal entities necessary for the performance of its supervisory functions in respect of banking, insurance, and securities market supervision. Article 15 further authorizes the FSA to coordinate its activities with other Kazakhstani governmental bodies and foreign governmental bodies within the framework of its competencies and within the limits established by international agreements.</p> <p>Banking</p> <p>The FSA has signed a Memorandum of Understanding (MOU) with Turkey, which permits the FSA to carry out on site inspections of Kazakhstani bank subsidiaries in Turkey. The MOU with Turkey, however, does not cover sharing of information upon request related to suspicious transactions or provision of mutual legal assistance in respect of money laundering or terrorist financing investigations or cases. The FSA plans to sign more MOUs with counterpart supervisory authorities in other countries.</p> <p>Insurance</p> <p>The Insurance Supervisory Department has been a member of IAIS since 2000. Insurance supervisors, who are members of IAIS, generally cooperate informally with each other through this network usually through sending and receiving letters and requests. There are no MOUs signed with counterpart agencies in foreign countries that provide for the sharing of information upon request related to suspicious transactions or provision of mutual legal assistance in respect of money laundering or terrorist financing investigations or similar cases.</p> <p>Securities</p> <p>Article 43 of the Securities Law provides that the FSA has a right to request and receive information required for its activity in the securities market from the government authorities, issuers, licensees, and SROs. Articles 41–44 of this law set forth what information can be disclosed publicly by the FSA, and what information is not subject to public disclosure. The FSA is empowered to cooperate with foreign regulators, to share information, and to coordinate activities in the field of prevention and avoidance of violations in the securities market. As there are no MOUs signed that relate to sharing of information on request between foreign counterpart authorities in respect of money laundering or terrorist financing investigations or prosecutions, the ability to share such information is not clear.</p>
<p>Analysis of Effectiveness</p>
<p>Although Article 14 of the FSA Law empowers the FSA to obtain information from individuals and legal entities necessary for the performance of its supervisory functions in respect of banking, insurance, and securities market supervision, it is not clear that this provision is applicable to sharing of information, which would include confidential financial information, upon request, in respect of money laundering or terrorist financing, with counterpart foreign agencies.</p> <p>The MOU signed by Kazakhstan and Turkey does not cover the sharing of information with foreign counterpart agencies, upon request that might include confidential financial information for the purpose of cooperation in prevention and detection of money laundering or terrorist financing.</p>
<p>Recommendations and Comments</p>

Kazakhstan should sign and implement relevant international agreements relating to the provision of mutual legal assistance in criminal cases, and should continue to pursue signing MOUs with respective counterpart agencies abroad, which specifically authorize informal sharing of information (including confidential information) upon request where money laundering or terrorist financing is suspected. Upon creation of the FIU, it should be a high priority of the FIU to sign MOUs with FIUs abroad.
Implications for compliance with FATF Recommendation 26
FATF Recommendation 26: Materially non-compliant.

Description of the controls and monitoring of cash and cross border transactions

Table 5: Description of the Controls and Monitoring of Cash and Cross Border Transactions

FATF Recommendation 22:
Description
<i>A person leaving the territory of Kazakhstan must complete customs declaration in case of transporting more than the equivalent of US\$3,000. It is prohibited to export cash equivalent to more than US\$10,000 without an export license from the NBK.</i>
<i>A person leaving the territory of Kazakhstan must declare bearer negotiable instruments.</i>
<i>There are no restrictions on importing any amounts of cash into the country.</i>
FATF Recommendation 23:
Description
<i>The Currency Law requires reporting of all transactions by physical persons in the amount US\$50,000 (equivalent) to the NBK.</i>
Interpretative Note to FATF Recommendation 22:
Description
<i>Customs declarations must be completed for the export of the equivalent US\$3,000. As the conversion and use of foreign currency by Kazakhstani residents is still subject to a currency controls, which requires licenses for such transactions, the Currency Control Department of the NBK maintains these records and issues licenses. The currency controls are expected to be phased out by 2007.</i>

C. Ratings of Compliance with FATF Recommendations, Summary of Effectiveness of AML/CFT Efforts, Recommended Action Plan, and Authorities' Response to the Assessment

Table 6. Ratings of Compliance with FATF Recommendations Requiring Specific Action

FATF Recommendation	Based on Criteria Rating	Rating
1-Ratification and implementation of the Vienna Convention	1	Materially non-compliant
2-Secrecy laws consistent with the 40 Recommendations	43	Non-compliant.
3-Multilateral cooperation and mutual legal assistance in combating ML	34, 36, 38, 40	Materially non-compliant.

4-ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses.	2	Materially non-compliant
5-Knowing ML activity a criminal offense (Vienna Convention)	4	Largely compliant.
7-Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	7, 7.3, 8, 9, 10, 11	Materially non-Compliant.
8-FATF Recommendations 10 to 29 applied to non-bank financial institutions; (e.g., foreign exchange houses)		Materially non-compliant.
10-Prohibition of anonymous accounts and implementation of customer identification policies	45, 46, 46.1	Largely compliant.
11-Obligation to take reasonable measures to obtain information about customer identity	46.1, 47	Materially non-compliant.
12-Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	52, 53, 54	Materially non-compliant.
14-Detection and analysis of unusual large or otherwise suspicious transactions	17.2, 49	Non-compliant.
15-If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	55	Non-compliant.
16-Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	56	Non-compliant.
17-Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	57	Non-compliant.
18-Compliance with instructions for suspicious transactions reporting	57	Non-compliant.
19-Internal policies, procedures, controls, audit, and training programs	58, 58.1, 59, 60	Materially non-compliant.
20-AML rules and procedures applied to branches and subsidiaries located abroad	61	Non-compliant.
21-Special attention given to transactions with higher risk countries	50, 50.1	Materially non-compliant.
26-Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	66	Materially non-compliant.
28-Guidelines for suspicious transactions' detection	17.2, 50.1, 55.2	Non-compliant.
29-Preventing control of, or significant participation in financial institutions by criminals	62	Largely compliant.
32-International exchange of information relating to suspicious transactions, and to persons or corporations involved	22, 22.1, 34	Materially non-compliant.
33-Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	34.2, 35.1	Did not rate.
34-Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	34, 34.1, 36, 37	Largely compliant.

37–Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	27, 34, 34.1, 35.2	Materially non-compliant.
38–Authority to take expeditious actions in response to foreign countries’ requests to identify, freeze, seize and confiscate proceeds or other property	11, 15, 16, 34, 34.1, 35.2, 39	Materially non-compliant.
40–ML an extraditable offense	34, 40	Largely compliant.
SR I–Take steps to ratify and implement relevant United Nations instruments	1, 34	Materially non-compliant.
SR II–Criminalize the FT and terrorist organizations	2.3, 3, 3.1	Non-compliant.
SR III–Freeze and confiscate terrorist assets	7, 7.3, 8, 13	Materially non-compliant.
SR IV–Report suspicious transactions linked to terrorism	55	Non-compliant.
SR V–provide assistance to other countries’ FT investigations	34, 34.1, 37, 40, 41	Materially non-compliant.
SR VI–impose AML requirements on alternative remittance systems	45, 46, 46.1, 47, 49, 50, 50.1, 52, 53, 54, 55, 56, 57, 58, 58.1, 59, 60, 61, 62	Non-compliant.
SR VII–Strengthen customer identification measures for wire transfers	48, 51	Not rated.

62. Table 7 shows the results of the about 40 assessments that have been done using the 2002 methodology. It allows for a comparison with the results of the assessment of Kazakhstan (Table 6).

Table 7. Profile of Overall Compliance with FATF Recommendations

FATF Recommendations	Compliant (in percent)	Largely Compliant (in percent)	Materially Noncompliant (in percent)	Noncompliant (in percent)	Assessed Jurisdictions (number)
The Forty Recommendations					
1 – Ratification and implementation of the Vienna Convention	82	8	10	0	39
2 – Secrecy laws consistent with the 40 Recommendations	63	18	15	5	40
3 – Multilateral cooperation and mutual legal assistance in combating ML	45	30	20	5	40
4 – ML a criminal offense (Vienna Convention) based on drug ML and other serious offenses	68	23	5	5	40
5 – Knowing ML activity a criminal offense (Vienna Convention)	73	15	2	10	41
7 – Legal and administrative conditions for provisional measures, such as freezing, seizing, and confiscation (Vienna Convention)	40	45	10	5	40
8 – FATF Recommendations 10 to 29 applied to non-bank financial institutions (e.g. foreign exchange houses)	7	50	29	14	14
10 – Prohibition of anonymous accounts and implementation of customer identification policies	20	55	23	3	40
11 – Obligation to take reasonable measures to obtain information about customer identity	22	44	27	7	41
12 – Comprehensive record keeping for five years of transactions, accounts, correspondence, and customer identification documents	40	38	23	0	40
14 – Detection and analysis of unusual large or otherwise suspicious transactions	28	30	28	15	40
15 – If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the FIU	39	29	22	10	41
16 – Legal protection for financial institutions, their directors and staff if they report their suspicions in good faith to the FIU	78	10	3	10	40
17 – Directors, officers and employees, should not warn customers when information relating to them is reported to the FIU	58	28	8	8	40
18 – Compliance with instructions for suspicious transactions reporting	63	13	8	18	40
19 – Internal policies, procedures, controls, audit, and training programs	33	35	30	3	40
20 – AML rules and procedures applied to branches and subsidiaries located abroad	38	22	22	19	32
21 – Special attention given to transactions with higher risk countries	37	20	20	24	41
26 – Adequate AML programs in supervised banks, financial institutions or intermediaries; authority to cooperate with judicial and law enforcement	38	23	33	8	40
28 – Guidelines for suspicious transactions' detection	37	24	32	7	41
29 – Preventing control of, or significant participation in financial institutions by criminals	45	30	18	8	40
32 – International exchange of information relating to suspicious transactions, and to persons or corporations involved	46	22	15	17	41
33 – Bilateral or multilateral agreement on information exchange when legal standards are different should not affect willingness to provide mutual assistance	51	32	11	5	37
34 – Bilateral and multilateral agreements and arrangements for widest possible range of mutual assistance	53	25	20	3	40
37 – Existence of procedures for mutual assistance in criminal matters for production of records, search of persons and premises, seizure and obtaining of evidence for ML investigations and prosecution	44	22	32	2	41
38 – Authority to take expeditious actions in response to foreign countries' requests to identify, freeze, seize and confiscate proceeds or other property	33	45	18	5	40
40 – ML an extraditable offense	61	17	7	15	41
Eight Special Recommendations on Terrorist Financing					
SR I – Take steps to ratify and implement relevant United Nations instruments	37	32	18	13	38
SR II – Criminalize the FT and terrorist organizations	43	15	10	33	40
SR III – Freeze and confiscate terrorist assets	40	25	15	20	40
SR IV – Report suspicious transactions linked to terrorism	41	18	13	28	39
SR V – Provide assistance to other countries' FT investigations	43	10	25	23	40
SR VI – Impose AML requirements on alternative remittance systems	18	18	18	45	11
SR VII – Strengthen customer identification measures for wire transfers	9	30	27	33	33
SR VIII – Ensure that entities, in particular nonprofit organizations, cannot be misused to finance terrorism	33	0	33	33	3

Sources: Assessment reports of countries participating in the pilot project.

Table 8. Summary of Effectiveness of AML/CFT Efforts for Each Heading

Heading	Assessment of Effectiveness
Criminal Justice Measures and International Cooperation	
I—Criminalization of ML and FT	The definition of ML is not in compliance with the international conventions. A wider scope of predicate offenses should be targeted by the authorities regarding ML since currently predominantly tax offenses are targeted. There is no criminalization of FT in the Criminal Code and the definition of FT in the law is inadequate. There is no legal basis for implementing UN Security Council Resolutions.
II—Confiscation of proceeds of crime or property used to finance terrorism	The confiscation regime in Kazakhstan has both property- and value-based provisions, but is not mandatory. The regime applies to economic benefits deriving from any criminal offense. Confiscation requires a criminal conviction, but freezing and seizing are available on a provisional basis. Assets and proceeds from conduct outside the offense are subject to provisional measures and may be subject to confiscation at the sole discretion of the judge. Defendants, who have fled, may be prosecuted when absent, and confiscation of a fugitive’s assets is also permissible. When a defendant dies before prosecution, assets are returned to the defendant’s family or others pursuant to the laws of succession. If there are no successors, the assets would be forfeited to the state.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	Because there is no FIU and no duty on financial institutions or other relevant bodies to report suspicious activities, the AML/CFT framework of Kazakhstan is significantly weakened.
IV—Law enforcement and prosecution authorities, powers and duties	Generally speaking, in Kazakhstan there seems to be a system in place ensuring that offenses (ML included) are properly investigated. The mission expresses its reservations concerning whether the system currently is adequate to enable proper investigations of money laundering and terrorist financing offenses.
V—International cooperation	Chapter 55 of the Criminal Procedure Code requires Letters Rogatory for non treaty countries. This effectively limits the timely provision of mutual legal assistance to those countries with which Kazakhstan has a bilateral treaty, or where the prosecutor is part of the judiciary. Only in very rare circumstances will the prosecutor’s office be a competent judicial authority, and thus most countries will be required to use “Letters Rogatory,” a process which, at best, is slow and cumbersome because it must be processed through diplomatic channels. Such reliance on letters rogatory ensures that neither expeditious nor effective cooperation can be given in ML investigations and prosecutions.
Legal and Institutional Framework for All Financial Institutions	
I—General framework	The FSA is the designated authority for integrated supervision, regulation, and licensing of the banking, insurance, and securities sectors. As a new agency, however, it has not yet audited or penalized any entities for non-compliance with laws or regulations. The bank secrecy provisions of the Banking Law obligate bankers

	<p>and financial sector supervisory officials to turn a blind eye to highly suspicious criminal activity. There are no “safe harbor” provisions to protect bankers or public officials from criminal prosecution for reporting suspected criminal activities to authorities. Thus, the banking secrecy provisions of the Banking Law are wholly incompatible with FATF Recommendation 2.</p>
II—Customer identification	<p>Although various banking regulations set forth some requirements for account opening and transaction documentation, they are insufficient in obligating the bankers to sufficiently “know” the customer, the purpose of the transactions, or the client’s business in order to sufficiently determine whether transactions are suspicious. The customer identification documentation requirements for banks do not permit anonymous or numbered accounts, but these requirements do not apply to insurance or securities entities or professionals.</p> <p>UN and US terrorist lists are used on a voluntary basis by financial sector entities and professionals to screen clients. However, this screening is not mandatory and non-compliance is not yet subject to penalties.</p>
III—Ongoing monitoring of accounts and transactions	<p>Although Article 24 of the NBK Regulation on Internal Controls requires bank staff to report suspicious transactions to the bank’s own Internal Control Unit, such transactions may not be reported to authorized authorities. This requirement to maintain internal records on suspicious transactions does not apply to the insurance or securities sector.</p> <p>Although a provision of the Currency Control Law requires banks to report transactions of a single client in a single month which total more than US\$50,000, the Currency Control Department of the NBK is prevented using this data to reporting suspicious transactions to an authorized authority.</p>
IV—Record keeping	<p>Although NBK Currency Control regulations require maintaining documentation related to foreign currency transactions for five years, the maintenance requirement is not generally applicable to transaction documentation, which does not involve foreign currency transactions. The NBK Regulation on Account Opening Documentation requires that all client documentation be maintained for five years is appropriate.</p> <p>The securities industry has systems for transaction documentation due to the fact that transactions are executed on the Stock Exchange and through the Central Securities Depository. However, there is no requirement for market participants to maintain customer identity documentation or transaction records for a minimum of five years.</p>
V—Suspicious transactions reporting	<p>The NBK regulation, which requires banks to maintain internal records of suspicious transactions, is not sufficient, since it prevents this information from getting to authorities, who could act on such information.</p>
VI—Internal controls, compliance and audit	<p>There is no legal requirement for banking, insurance, or securities market participants to designate an AML/CFT Compliance Officer or for staff training.</p> <p>The NBK Regulation on Account Opening Documentation falls short in obligating financial institutions to take effective action to understand the client, the clients business, and in making a</p>

	reasonable assessment as to whether the funds of the client are from legitimate sources.
VII—Integrity standards	The FSA’s procedures for licensing pursuant to determinations made by the FSA’s Qualification Committee are appropriate, but documents should be verified. However, the grounds upon which the FSA may deny a license to an applicant do not include denial based on reliable information that the applicant is (or has been) involved in suspected criminal activity or denial on the grounds of past criminal activity where sentence has been served, or where applicant is the subject of current criminal investigation.
VIII—Enforcement powers and sanctions	It appears that the FSA will be the authority to enforce, audit, and penalize non-compliance of banks, insurance, and securities companies/professionals with AML/CFT law obligations. Although there exist some bank regulations concerning customer identification and reporting suspicious transactions to an Internal Audit unit within the bank (although not to authorities), no AML/CFT law does yet exist, and these entities are not yet legally obligated to comply with effective requirements, which would prevent and detect money laundering or terrorist financing.
IX—Co-operation between supervisors and other competent authorities	Although Article 14 of the FSA Law empowers the FSA to obtain information in the performance of its supervisory functions in respect of banking, insurance, and securities market supervision, it is not clear that this provision is applicable to sharing of information, which would include confidential financial information, upon request, in respect of money laundering or terrorist financing, with counterpart foreign agencies.

Table 9. Recommended Action Plan to Improve the Legal and Institutional Framework and to Strengthen the Implementation of AML/CFT Measures in Banking, Insurance and Securities Sectors

Criminal Justice Measures and International Cooperation	Recommended Action
I—Criminalization of ML and FT	<ul style="list-style-type: none"> - Amend the definition of money laundering in Article 193 of the Criminal Code so that the definition meets current international standards as set out in the international conventions. - Train officials so that all officials realize that money laundering and illicit proceeds can exist alongside almost any offense, which generates illegal proceeds, including drugs offenses and the illegal weapons trade. - Create an offense of financing of terrorism in the Criminal Code. - Sign, ratify, and implement the Palermo and Strasbourg Conventions. - Fully implement the Vienna Convention. - Fully implement the ICSFT Convention.
II—Confiscation of proceeds of crime or property used to finance terrorism	<ul style="list-style-type: none"> - Make confiscation of criminal proceeds in ML and TF matters mandatory, that is, that the courts are obliged to consider the issue and to the extent proceeds exist confiscate them. - Enact a law regarding the implementation of the UNSCRs making the review of names mandatory, the processes of financial

	institutions subject to review by competent authorities, the failure to comply subject to sanction, and obviating the requirement for a judge in Kazakhstan to pronounce judgment regarding natural and legal persons being terrorists.
III—The FIU and processes for receiving, analyzing, and disseminating financial information and other intelligence at the domestic and international levels	<ul style="list-style-type: none"> - Creation of a FIU should be a priority for the authorities. - Financial institutions must be under a duty to file suspicious transaction reporting to the FIU. The FIU should issue guidelines for the identification of complex or unusual transactions, and suspicious patterns of behavior. The FIU should be able to obtain additional documentation from reporting parties to assist in its analysis of financial transactions. The FIU should have access to financial, administrative, and law enforcement information on a timely basis to enable it to adequately undertake its responsibilities. The FIU or another should also be able to order sanctions or penalties against reporting parties for failure to comply with their reporting obligations.
IV—Law enforcement and prosecution authorities, powers and duties	<ul style="list-style-type: none"> - <i>Keeping statistics of investigations initiated on the basis of STRs and statistics on FT investigations, prosecutions, and convictions should be an integral part of statistics system.</i> - <i>Training is necessary for the law enforcement in order to reach modern knowledge in the fields of asset tracing, ML, and FT.</i> - <i>There should be also in place a detailed and comprehensive regulatory mechanism to implement freezing and seizure of proceeds of, or used in, or intended or allocated for use in the FT.</i> - <i>Special attention should be paid to the procedure of freezing related to the lists of UN Security Council resolutions.</i>
V—International cooperation	<ul style="list-style-type: none"> - Enact appropriate laws and procedures to provide the widest possible range of mutual legal assistance in AML/CFT matters in a timely fashion. Kazakhstan should consider additional provisions on mutual assistance, which would allow it to give such assistance on a case-by-case basis without the need for a bilateral or multilateral treaty and without the need for the formalized and lengthy “Letters Rogatory” process. - Kazakhstan should consider increasing the number of bilateral treaties, particularly with Western European countries and with North America.
Legal and Institutional Framework for Financial Institutions	
I—General framework	<ul style="list-style-type: none"> - An AML/CFT law, which meets international standards, should be expediently enacted to address the AML/CFT risks in Kazakhstan due to its geographic location and its booming economy. The FSA should be obligated to enforce compliance with obligations under this law. - The banking secrecy provisions, and other financial sector secrecy laws, should be amended to allow for reporting information on suspicious transactions and clients to an authorized body, which has authority to detect and prevent money laundering and terrorist financing.
II—Customer identification	An AML/CFT law should obligate designated entities to use professional discretion and judgment in assessing the potential risks that certain clients may be engaged in criminal or terrorist activities. In addition, relevant regulations should stipulate that the

	documentary requirements for account opening and executing payment transactions is the minimum standard required in all client relations. Regulations should be elaborated to ensure all entities covered by AML/CFT obligations are required to conduct regular risk assessments of client categories and politically exposed persons for the purpose of implementing heightened know-your-customer documentation requirements for those which present higher risks for money laundering or terrorist financing.
III—Ongoing monitoring of accounts and transactions	An AML/CFT Law should require all persons/entities it covers to implement policies and procedures for on-going monitoring of transactions and accounts to identify and report suspicious transactions. These procedures should require enhanced monitoring for clients/customers, which represent higher risks for money laundering or terrorist financing to the institution.
IV—Record keeping	An AML/CFT law and relevant regulations should require that all persons and entities subject to it, maintain all transaction documents and client records for a minimum of five years. Such records should be maintained in a manner that they are easily searchable and available to authorities who must have access to them.
V—Suspicious transactions reporting	Enactment of an AML/CFT Law, which meets international standards, including establishing an FIU, requiring the reporting of suspicious transaction to authorized authorities, amending the bank secrecy provisions of the Banking Law to allow for the reporting of suspicious transactions, and inclusion of prohibitions for tipping off, should be a high priority.
VI—Internal controls, compliance and audit	The function of AML/CFT Compliance Officer should be a separate function from the Internal Control/Audit function, as the effectiveness of compliance with AML/CFT obligations should be tested by persons other than those who designed and implemented them. The AML/CFT law and relevant regulations should require a formally designated AML/CFT Compliance Officer responsible for drafting and implementing internal AML/CFT compliance procedures as well as staff training. This requirement should apply to all branches and subsidiaries.
VII—Integrity standards	Law and regulations related to licensing financial sector entities should give the FSA legal authority to reject or deny license applications from applicants suspected of involvement in criminal activity, or have a past criminal history connected to economic, financial, or related crimes, whether or not the full sentence has been served.
VIII—Enforcement powers and sanctions	An AML/CFT law should be enacted which sets forth effective requirements that would prevent and detect money laundering or terrorist financing. It should include provisions on know-your-customer, suspicious transactions or cash transaction reporting, recordkeeping, and account monitoring obligations. Additional amendments should be made to relevant laws and regulations, which require financial sector entities to implement the AML/CFT law obligations. The FSA should supervise compliance with these requirements, regularly audit compliance, and penalize instances of non-compliance.
IX—Co-operation between supervisors and other competent authorities	Kazakhstan should sign and implement relevant international agreements relating to the provision of mutual legal assistance in

	criminal cases, and should continue to pursue signing MOUs with counterpart agencies abroad which specifically authorize informal sharing of information (including confidential information) upon request where money laundering or terrorist financing is suspected. Upon creation of the FIU, it should be a high priority of the FIU to sign MOUs with counterpart FIUs abroad.
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Authorities' response

The authorities concurred with the assessment. They expect that the practical implementation of the recommendations on amending the existing legal and institutional framework will become rather complex.