

BUILDING THE FUTURE

For the 30th Anniversary
of the Independence
of the Republic of Kazakhstan





BUILDING THE FUTURE

Second revised edition dedicated
to the 30th Anniversary of the Independence
of the Republic of Kazakhstan

ALMATY
2021



DEAR READERS!

Kazakhstan Stock Exchange is pleased to present you the second revised edition of the book called "Building the future", 2021. The first edition was issued in 2018 and timed to coincide with the 25th anniversary of KASE. The stock exchange development history was recreated based on the memories of almost a hundred participants in the events, official documents and numerous publications in the media.

The book aroused great interest on the part of the financial community, students, readers concerned with the history of the country. The book written in the context of the country's memorials covered the most important events since 1991 being a historic year for Kazakhstan the year of declaration of independence and adoption of a Constitutional Act "On State Independence of the Republic of Kazakhstan". Hard work has been undertaken on the way to sovereignty to establish state and economic institutions, the national security system, financial and exchange infrastructure. The national currency which was put into circulation by the republic on November 15, 1993 finally established the independent economic policy of the country. On November 17, 1993, just two days after putting the national currency into circulation, the Kazakh Interbank Currency Exchange was founded and the first Tenge trades took place. This date became the actual KASE birthday. As of today, the exchange has passed several stages of modernization and continues to develop dynamically, considerably contributing to the economy of Kazakhstan.

Since the publication of the first edition of the book, important events occurred on Kazakhstan Stock Exchange, which provided a new impetus to the development of not only KASE, but the country's whole stock market. One of such events is a strategic partnership among KASE and Moscow Exchange. Thanks to this KASE carried out successful IT modernization, introduced the Central counterparty services, launched trades using new tools and continues to develop the exchange services.

We hope that the new revised edition will also be warmly welcomed by the readers and will become a table-book for them.

We are grateful to all our colleagues, partners, financial regulators who responded to our request and provided support sharing their memories, facts, documents, personal stories. This made it possible to take a look at the recent past of KASE and the country's stock market in an informative and exciting way.

We heartily congratulate our coauthors and all people of Kazakhstan on the 30th anniversary of independence of Kazakhstan and wish success and new achievements for the benefit of our homeland.

KASE



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Chapter 1

IN THE BEGINNING WAS THE TENGE

NEW EXCHANGE FOR THE NEW CURRENCY

THE PRICE OF INTER-OFFSET

THE FIRST STABILITY

FLOATING EXCHANGE RATE AS A RESPONSE TO CRISIS

Chapter 1.

IN THE BEGINNING WAS THE TENGE

In the history of the establishment of independent Kazakhstan, the year 1993 stands on a financial pedestal. The introduction of the national currency on November 15 has finally consolidated the national sovereignty, and the economy of Kazakhstan has received a fundamental factor of financial and economic independence.

An independent integral financial system of the country was effectively formed. A currency exchange became the cornerstone of the system along with the National Bank, the Ministry of Finance, and second-tier banks. Officially, it was established as an independent legal entity two days after Kazakhstan switched to the tenge – on November 17, 1993. And this date made it into history of the financial system of Kazakhstan as KASE's birthday. According to the official documents about the establishment of the Kazakh Interbank Currency Exchange (KICE), arrangement and development of the national foreign exchange market in connection with the introduction of the tenge were the main tasks assigned to KICE then.

This was preceded by consistent focused efforts. Since the declaration of independence on December 16, 1991, the state accelerated formation of the attributes of sovereignty, such as symbols and legal framework, delineated the state border, established government institutions, and formed economic and financial infrastructure. However, it was the establishment of an independent financial system with its own currency and institutions that provided actual independence in conducting the economic policy.

In June 1992, the Strategy for the Establishment of Kazakhstan as a Sovereign State¹ was adopted, and a legislative package had been earlier formed; it included laws regulating financial activities as well, such as *On Banks*², *On Circulation of Securities and the Stock Exchange*³, *On Currency Exchange Regulation*⁴. At the same time, the State Commission of the Republic of Kazakhstan on the Introduction of the National Currency was established chaired by the Prime Minister of Kazakhstan Sergey Tereshchenko, as well as a workgroup to develop calculations and details of the project. The members of the group headed by the First Vice Prime Minister Daulet Sembayev were Oraz Zhandossov, Lyudmila Volodina, Umirzak Shukeyev, Valentin Nazarov, Viktor Sobolev, and Grigoriy Marchenko.

The accelerated transition to the national currency happened due to the hardest economic conditions experienced by the republic. By the time the tenge was introduced, the hyperinflation rate was estimated at 2,165%. In comparison with 1992, the decline in GDP reached 40%, and the rate of production dropped by 9.2%.

By 1993, the dollar exchange rate had reached 990 rubles. The situation became even more disastrous after July 26, 1993, when Russia unilaterally introduced a new type of ruble instead of the fully depreciated Soviet ruble regardless of any arrangements with Kazakhstan.

Then it became obvious to everyone that a delay in the transition to its own currency could result in an economic catastrophe. "We made up a secret document for the President, listed all the pros and cons and made a proposal to end negotiations and concentrate efforts on the introduction of our own national currency," Daulet Sembayev⁵ says. "The thing was that we had already assumed such an outcome and developed a design, decided on technical issues of making banknotes and were ready to introduce our own currency. Therefore, it had already been printed and imported into the republic by that time. The President established a government commission, which included a workgroup that made up the entire scenario of the tenge introduction. It was a comprehensive set of political, economic, technical, and organizational measures under the conditions where Kazakhstan turned into a pit for dumping old-style notes. All further work on the tenge introduction was done by the specialists of the National Bank and second-tier banks for five days. People were literally ready to drop with fatigue, but we had to complete the exchange in a very short period of time in order to cut off excess money, transfer such money to special accounts until the sources of origin were clarified."⁶

When introducing the tenge, certain measures were taken to ensure its legitimacy. Kazakhstan held negotiations with international financial organizations. On November 3, 1993, an agreement On Mutual Obligations and Mutual Support in connection with the Introduction of the National Banknotes by the Republic of Kazakhstan was signed with Russia. The leaderships of neighboring countries were also informed of the upcoming event. A number of diplomatic, foreign trade, and organizational issues were settled.

The national currency was delivered to the regions; old Soviet rubles were accepted and recounted. According to the published data, the Kazakhstani brought more than a trillion old Soviet rubles for exchange. The history of the tenge began...

NEW EXCHANGE FOR THE NEW CURRENCY

Before the birth of the tenge, trading in foreign currency, which began its market circulation in the country with the independence, was provided by a special unit of the National Bank – the Center of Interbank Currency Transactions (Currency Exchange). The establishment of the Center was initiated by Duisen Shindauletov, who had experience working in banks, was familiar with the activities of the USSR VEB (Vnesheconombank) and USSR VTB (Vneshtorgbank), and was eager to establish an exchange similar to the world financial powerhouses in Kazakhstan.

At the beginning of 1992, his idea was supported by the Chairperson of the Management Board of the National Bank Galym Baynazarov⁷, and by the summer of the same year the development of regulatory documents had been completed, and on June 23, the Center held the first trading in the US dollars, which subsequently became regular. The first team of the Center included Duisen Shindauletov, Nurlan Amirzhanov, Arman Botpayev, Bakytzhan Konkashev, Gulnara Sakhipova; they were truly committed professionals, therefore, by the time of the appearance of KICE, its "forerunner" was a rather advanced organizational and technical platform, where regular trading in the US dollar and Deutsche mark⁸ was held.

However, the appearance of the national currency required further development of the foreign exchange market. Therefore, it was necessary to provide the center, which was not an independent legal entity, with the status of an independent exchange and changing the status of the Exchange was one of the first issues. In 1993, the National Bank offered Zeynulla Kakimzhanov to head the Currency Exchange.⁹

According to Bakytzhan Konkashev, who headed the software department of the Center of Interbank Currency Transactions in 1993, "We needed changes to make the trading floor independent. Implementation of the idea of corporatization of the Exchange and the elimination of conflicts of interest for the status of the National Bank was one of the key decisions. The idea of corporatization was supported by commercial banks and the National Bank. This resulted in starting a new "era" in the history of the Exchange. Pretty quickly – on November 17, 1993 – the Exchange was established as an independent legal entity. At the same time, the National Bank received the same holding of shares as other founding banks, but a "golden share" was also assigned to NB, which gave it a "veto" to make decisions at a general meeting of shareholders. The financial market of the country is the area of responsibility of the National Bank, and it should not allow any strong fluctuations, influences, speculations. Following the Exchange corporatization, the Exchange management was changed, Zeinulla Kakimzhanov replaced Shindauletov."¹⁰

At that time, a lot was done based on enthusiasm and sometimes intuition. People who burned with the idea of developing the national structures, institutions of independence, had an internal understanding of how this should ideally be, what principles should be laid. The lack of special knowledge was balanced with studying the best practices of other countries and states, which had passed the same way of becoming independent, and adapting such practices to the national realities. We acted quickly, and although many documents were made up urgently, they were consistent and subsequently worked for many years, in fact constituting the basis of the legislative framework of the country's economy. The first charter of the Exchange was born in the same manner. The charter was designed by Azamat Dzholdasbekov¹¹ – an employee of a commercial bank then, Sauat Mynbayev¹², and Yerlan Baymuratov¹³.

According to Mr. Dzholdasbekov's memories of that time important to KASE, "After studying the experience of the Moscow Stock Exchange, the National Bank decided to fund a unit and make it an exchange. Since it was the initiative of the central bank, it was very well accepted. On November 17, twenty-four banks, including the National Bank, gathered and established the Exchange as an independent legal entity. We made up its charter for several hours and sent it to the Exchange for registration. We did not invent anything special, but agreed at once that the "one shareholder – one vote" would be the key principle. It meant, first of all, that the shares were divided equally between all members. And second, we decided for the future that even if the number of shares changed, the principle would remain the same – everyone had one vote each."¹⁴

Determining the exchange rate, the opening rate of the national currency to US dollar, was the key issue for the first exchange trades. This is how the task was described in the book *The 10th Anniversary of the National Currency of the Republic of Kazakhstan* published by the National Bank of Kazakhstan, "Particular attention was paid to procedural issues: the delivery of new currency to the field, the establishment of the exchange period and limit, the volume of exchange of bank accounts and other financial assets, as well as a ratio established as 1:500 (the USD-to-KZT exchange rate was 4.7). It was established that the tenge became a legal tender from the first day of the exchange."

*The President Nursultan Nazarbayev highlighted this topic in his book *The Way of Kazakhstan*¹⁵ as follows, "with commencement of work on the tenge introduction, new problems that we simply had not thought about before emerged, such as the choice of the exchange arrangement and exchange rate. We started discussing all pros and cons again with different options: with a floating rate, with a managed floating rate within the range, peg to a single currency (USD) or peg to a basket of currencies. We decided on the managed floating rate in the currency market. It was supposed to introduce a fixed rate of tenge with a monthly devaluation of 2–3% in the event that the country's foreign reserves would not be enough to manage the exchange rate effectively."*

The issue of determining the KZT to USD base exchange rate to start trading was also discussed at the constituent meeting of the Exchange on November 17, 1993. For the first trading we determined the exchange rate as follows: a ruble-to-dollar exchange rate, which was formed early September (before the massive influx of rubles from the neighboring republics), divided it into 500 and got the first market exchange rate of the tenge – 4.94. The base figure required to start and conduct the first trading was created.

The Kazakh Interbank Currency Exchange was officially established on November 17, 1993 and it was registered as a legal entity on December 30, 1993. The Exchange Council was also established at the constituent meeting, which was

the supreme governance body of the Exchange for the period between the general meetings. By the decision of the meeting, representatives of shareholders were elected to the Exchange Council¹⁶.

Two days after the establishment of the Exchange, the first historical foreign exchange trading in USD/KZT currency pair was held on the trading floor on November 19, 1993. The volume of trading amounted to USD 300,000. The rate was formed at KZT 4.68 per US dollar. The National Bank of Kazakhstan acted as the seller of dollars, and Kazkredsotsbank¹⁷ was the first buyer. It was open outcry trading with KZT 1 increment, and was held by the fixing method: when the supply and demand got equal, the rate was fixed.

On November 26, 1993, the first trading in Russian ruble took place. The exchange rate was fixed at KZT 3.84 per RUB 1,000.

Then the settlements on the Exchange took at least two days. In order to buy a foreign currency, it was necessary to credit the Exchange's account with the tenge in advance. The buyer received the purchased currency directly from the seller (not via the Exchange) on the following business day after the transaction had been made. As for Russian rubles, the settlement period could reach 15 days. Initially, trading was held once a week, usually on Fridays, and through an open outcry. Dealers of the banks participating in trading used to raise their plates with registration numbers and "announce" their selling or buying rate for the currency.

Before the end of the year, there were five more trades in the US dollars on the trading floor, the last of which was fixed at KZT 6.31. As for the over-the-counter market, according to different sources, KZT 4.5 was paid for USD 1 on the first day of the tenge existence, and KZT 5.82 was paid in December. The newborn currency got cheaper gradually. However, the very first and serious test of the tenge at that time occurred in 1994.

THE PRICE OF INTER-OFFSET

The introduction of the tenge gave rise to a legitimate and reasonable hope that the republic would actually determine the financial policy itself and would not allow the occurrence of the same situation, where decisions were made in other capital cities and nullified all attempts to overcome the consequences of the USSR collapse in the national economy.

*At that moment very few people had an understanding of the threats of the global world. "Many of our people from the old cohort did not understand an irreversible nature of what was happening. Since we had been closed to the whole world for so many years, we did not understand a threat of globalization to the fullest extent. However, we did not understand its opportunities either. We did not have a kind of "experience of existence" in the open world," Nursultan Nazarbayev recalled the time of gaining sovereignty in his book *The Way of Kazakhstan*.*

There was no understanding that the announcement of an open market economy would bring the tests caused by this very openness: just as the entire economy, the tenge would react to changes in the economic situation not only among its neighbors on the continent, but across the global world.

The only (and significant) difference was the fact that decisions on how to respond to challenges, risks and crises, what measures to take, and how to react were then made by the Government of Kazakhstan and the National Bank. It would be naive to expect that without practical experience in market solutions the country would take all steps in a flawless and accurate manner, and taking into account all factors and risks. The year 1994 like no other year showed that we had to learn from our own mistakes and experience. Therefore, they were so valuable...

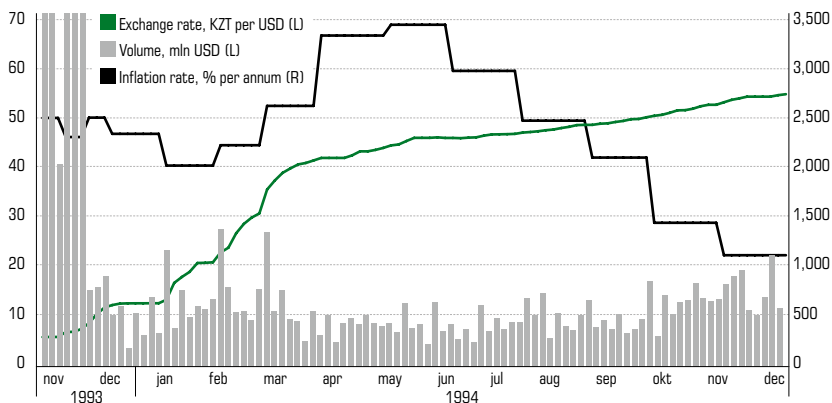
They tried to prevent the downward slip of the tenge, which started almost immediately after the introduction of the national currency, with the help of some administrative measures. In order to stabilize the tenge-to-dollar exchange rate, a mandatory sale of 50% of currency earnings from the export of goods, works, and services was temporarily imposed on all enterprises in January 1994. This had a positive effect on the volume of exchange trades and the liquidity of the foreign exchange market, and the dollar exchange rate stopped at KZT 11 by February. However, the Exchange gradually expanded its field of operation. From February 2, 1994 trading in the foreign currency was held twice a week – on Tuesdays and Thursdays. On July 14, the first historical trading in the Deutsche mark was held. The trading volume that day was 200,000 DM. The exchange rate was formed at KZT 29.78 per DM. Another important event took place in October 1994, when the first USD correspondent account of the Exchange opened and the transition to T+0 settlements in the US currency was made.

*At the same time, the Exchange actively developed its infrastructure, established correspondent relations. According to **Natalya Khoroshevskaya**, current deputy chairman of the Management Board of KASE, "By mid-1994, the first system appeared at the Exchange, which allowed receiving online statements from the correspondent account in tenge with the National Bank. We could see in real time which of the banks transferred which amount in tenge as an advanced payment in order to participate in exchange trading. It was a breakthrough number one. Breakthrough number two was the establishment of correspondent relations with foreign banks. By the end of 1995, the Exchange stopped delivering payment orders. Correspondent relations agreements were signed with foreign banks. As soon as this happened, the Exchange became the central party to the settlements in trading in foreign currencies. At the same time, the National Bank made an agreement with the Exchange that it would be able to connect to the most used system of interbank payments in the world – SWIFT. "Late 1994 – early 1995, the Exchange and the clearing house were integrated into the overall payment system of Kazakhstan. We quickly managed to create a correspondent network. These were US and European banks, because the settlements were made in US dollars and Deutsche marks, and Russian banks for settlements in Russian rubles. These three currencies were the first ones."¹⁸*

In 1994, the Government of Kazakhstan tried to “untangle” the problem of the nonpayment crisis, which had become catastrophic in the previous couple of years. Since enterprises had no money on their accounts, they could not pay for services and goods of their partners and suppliers. Those did not get money for the work done, and could not make settlements with anyone either. There was a vicious circle: the manufacturers produced and sent the products to warehouses and got no money for them. Barter transactions helped for some period of time, but everyone understood that no businesses would survive without money. Total outstanding sums in the republic amounted to trillions of rubles (the tenge already existed, but old debts were counted in rubles). Therefore, the government decided to conduct an intersectoral offset of mutual claims. The method was simple: a direct issue of money to the accounts of enterprises to replenish their working capital at a low interest rate. This led to the fact that in March 1994 only the money supply reached KZT 58 bn, which is 3.8 times more than in February and seven times more than at the beginning of 1994.

*The loans were special-purpose ones – to complete the settlements pursuant to List 2 (outstanding payment claims against the enterprise account). According to the Member of the Board of Directors of Bank CenterCredit JSC **Vladislav Li**¹⁹, who was the member of the Exchange Council then, “We thought that everyone would repay debts, and, in the end, everything would stabilize. But it turned out to be the opposite: all the money flowed to the free money market, and the dollar immediately zoomed up to 40. By mid-1994, the national currency depreciated tenfold! This was the price of the inter-offset – the market was deluged with money not secured by the mass of commodities.”²⁰*

THE DYNAMICS OF THE USD TO KZT EXCHANGE RATE, USD EXCHANGE TRADING VOLUME IN 1993–1994 AND INFLATION RATE



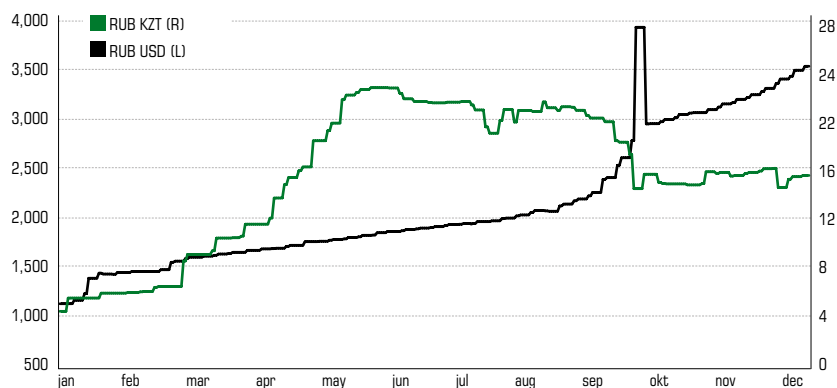
This meant that instead of paying debts and solving the problem of mutual non-payments, enterprises and banks brought this money to the Exchange, seeking to convert it into dollars in order to make profit from commercial transactions with imports, and also from exchange rate differences. This affected the tenge exchange rate. By June 1, USD 1 cost KZT 40.73. According to the Exchange, just four months later the KZT/USD exchange rate dropped from 11.58 to 43.29 – almost 274%!

By the end of 1994, the dollar had gone more than tenfold up to KZT 54.26. The depreciation of the national currency was followed by hyperinflation in the country, which reached 2,169.8% in 1993 and 1,160.3% in 1994 (according to other sources, 1,158.3%). But the change in the tenge exchange rate was insignificant compared to the catastrophic depreciation of the Russian ruble that had been experienced before. Moreover, the public was not yet accustomed to the new currency, and just few people used dollars at that time and the initial rate of KZT 4.7 per one US dollar was fixed for a very short period of time.

As a result, only 22% of borrowed funds allocated to the enterprises were refunded to the budget. Another stressful event of the year was the “imported crisis”, i.e. the collapse of the ruble against the dollar on October 11, 1994. The date was called “Black Tuesday”. On that day, the dollar exchange rate rose from RUB 2,833 to 3,926 per USD at the Moscow Interbank Currency Exchange²¹. The Chairperson of the Russian Central Bank Viktor Gerashchenko and Acting Minister of Finance of the Russian Federation Sergey Dubinin paid with their positions for that; according to the opinion of a specially established commission, for “uncoordinated, untimely, and sometimes incompetent decisions and actions of federal authorities”²².

That event and the inter-offset had an impact on the volatility of the KZT/RUB pair. If RUB 1,000 cost KZT 3.89 at the time of introduction of the tenge, KZT 5.74 in

THE DYNAMICS OF RUB-TO-KZT AND RUB-TO-USD EXCHANGE RATES IN 1994



January, and the maximum of KZT 22.7 (due to inter-offset) was reached in June; it cost KZT 16.67 in October, KZT 15.87 in November. The ruble continued falling on the following year. Taking into account the continuing close economic and human relations between the two countries, such instability of the currency pair and high market volatility had a negative effect on the entire economic situation in the country. In spite of the fact that on October 14, 1994 ("Red Thursday"), the RUB/USD exchange rate almost returned to the previous level of RUB 2,994 per one US dollar, it was that very lesson that had to be learned forever – external shocks and risks tended to affect the internal economic situation in the most serious way. In future, Kazakhstan and the young currency had to face those more than once. But the choice was nevertheless made – definitely in favor of a market economy with a developed financial system and the exchange financial market as a part.

THE FIRST STABILITY

After the trials of the previous year, the coming 1995 was almost calm. A slight "swing" of the currency sine wave was rather an easy ripple in the currency market compared to the storms of the preceding year. The USD/KZT pair fluctuated between KZT 55.43 for US dollar, starting from this position in January, up to KZT 63.97 in December. Following the changes in supply and demand in the market, the rate gradually rose until June, then gradually decreased until August, and increased to the above-mentioned rate in December.

As for the RUB/KZT pair, this sine wave was with a smaller increment. Starting from 14.83 KZT for 1,000 RUB in January, the pair was closer to the rate of KZT 13 throughout the year. The minimum rate was recorded in May – KZT 12.26 for RUB 1,000, and the year closed at KZT 13.86. We can say that the financial authorities of the country managed to restrain the volatility of the exchange rate.

The improved confidence in the national currency, improved balance of trade, reduced migrant transfers, and the introduction of new, more profitable financial instruments nullified the factor of increased demand for foreign currency. This made it possible to reduce the mandatory sale of currency earnings from 50% to 30%, and then fully cancel the same.

Another significant victory was the inflation rate reduced to 59.93% in 1995. Today it seems very high. However, it depends what to compare: this rate was 1,100.33% less than in 1994.

The Exchange also contributed to the stabilization of the currency market. As far back as on January 19, 1995, the trading schedule changed: trades were held three times a week – on Tuesdays, Thursdays, and Fridays. As of May 15, the Exchange switched to the daily schedule of trading in foreign currencies. What did it mean for the market? The answer is obvious – regular trading conducted according to the clear rules meant an increased availability of currency for business society, individuals (via foreign exchange offices) in any quantity and at any time. A very important market mechanism started operating in the currency market, and the

market got quite stable. There were almost no reasons for the unforgettable foreign exchange deficit and feverish demand for it.

The current director of the KASE Trading Department, who has been working on the Exchange since 1995, Yermek Mazhekenov provided a fairly detailed description of a working day of the trading floor of that time: "There were about 15–20 tables on the trading floor with traders from every bank sitting at them. They filled out pre-orders.

After accepting orders, the Exchange formed a consolidated statement, and the broker displayed this data on the big screen of a TV set, namely, supply and demand. If demand exceeded supply, the price moved upwards, and vice versa, these are the market laws. When in the course of trading, the demand was equal to the supply, the rate was fixed, and the trading was declared closed, and exchange certificates were issued for the bank traders, on the basis of which the bank had to transfer a particular currency for settlements. The trading increment was decided by a majority vote. Initially, it was a tiyin – one, five, ten...

Then there were small amounts, e.g. one million, five million dollars. However, they increased from year to year. It also reached 10 million. I remember that in the event when the daily trading volume exceeded 10 million, the Exchange treated all the participants in trading with champagne."²³

Meanwhile, the Exchange built up its own range of instruments and tested trading in so-called "soft currencies". The first successful trading in the Kyrgyz som took place on February 23, 1995. The exchange rate was KZT 5.3 per Kyrgyz som, and the trading volume amounted to KGS 540,000. The first and only successful trading in Ukrainian karbovanets was held on April 7 of the same year. Over 10,000 karbovanets were sold at a rate of KZT 4.5. The volume of trading on that day amounted to 16,068 million karbovanets.

In June 1995, the Exchange joined the international interbank system SWIFT²⁴ for transmitting information and making payments. This allowed the Exchange not only to automate the operation of the clearing house and thereby speed up the fulfillment of clients' orders, but also make payments around the world, exchanging information without any security concerns, since all information was transmitted via encrypted channels. Currently, over a million transactions for money transfers, interbank payments, securities pass through SWIFT daily, and KASE is still a member of this global system.

The organizational mechanism of exchange trading underwent fundamental changes. On August 7, 1995, the outdated fixing was replaced by the Frankfurt auction, which improved the transparency of exchange transactions. The first trading by this method were held in the US dollars. As of August 16, the afternoon trading in the US dollar started with preservation of settlements under the T+0 scheme. In fact, the Exchange entered the current trading mode. The growth in the volume and frequency of trading encouraged the Exchange to develop an electronic system to enter and process orders. The system, which was based on the continuous double auction, was launched on October 27, 1995.

FROM CHALK AND BLACKBOARD TO REMOTE TRADING

It is on the currency floor where the evolution of the modern KASE's trading system began. The first trades far back in the Center for Interbank Currency Transactions were conducted by open outcry, and the results were chalked on the blackboard.

"My team had a task to automate the trading process, dealers trading places, abandon paper bids and open outcry, and generate bids electronically," said Bakytzhan Konkashev, who headed the software department of the Center of Interbank Currency Transactions in 1993. "In order to solve these problems, a more advanced level of programming was required – computer equipment was rapidly entering our work and everyday life. I could no longer deal with the improvement of the trading program myself – the flow of documents increased, it was necessary to resolve issues of an organizational and technical nature. Therefore, we announced a competition and hired a software engineer Idel Sabitov. Idel wrote a program for network computer trading in the hall where each bank had its own place for dealers."³⁵

Idel Sabitov currently holds the position of Deputy Chairperson of the Management Board of Kazakhstan Stock Exchange JSC. He also created the first electronic system for trading in currencies using the counter auction. Developed with Clipper programming system, it was launched in October 1995 for trading in the US dollar and the Deutsche mark. The continuous counter auction by means of an electronic entry and processing of orders finally started being applied as the main method of trading in currencies from March 21, 1996. Fixing and open outcry remained in the Exchange's arsenal only as reserve methods of trading.

The Exchange simultaneously built up its hardware and technical potential. In

1995, with a focus on the expansion of the exchange trading in securities, it was decided to purchase modern equipment and the Automated Financial Instruments Trading System (ATS) developed by Australian Financial Markets Software Consultance. The system was installed and tested by the integrator company CMA Small Systems AB (Sweden). About one million US dollars of the Exchange equity was allocated for these purposes. There were thirty new Hewlett-Packard computers installed on the trading floor, and each trade participant got a personal workplace. The computers were powerful for that time: Intel Pentium 75 MHz processor, 4 MB RAM, 250 MB HDD, and HP 9000 server. Only two exchanges in CIS – KASE and MICE – had such technical capabilities.

Despite all the benefits, the purchased AST software was a closed trading and depository system, which was almost impossible to adapt to the ever-changing Kazakh legislation. The market developed actively, regulation improved, and AST restrained the development of the Exchange due to its "slowness". Therefore, in the third quarter of 1997, the Exchange employees Vyacheslav Kononenko and Alexandr Gavrilyuk developed their own software, Universal Trading Module, in C ++, which allowed them to work with external settlement and depository systems and integrate trades in currencies and securities. The commissioning of its own trading system in 1998 made it possible for the Exchange members to participate in remote trading and arrange the online transmission of trading data to the Reuters terminals, and later to BLOOMBERG³⁶ and to the Internet.

Kazakh Joint Stock Agro-Industrial Bank³⁷ was the first remote client of the Exchange; on August 19, 1998, the National Bank of the Republic of

Kazakhstan joined it as well as the Halyk Savings Bank of Kazakhstan on September 1.

Now this significantly upgraded software, continuously adapted to the current legislation and the current needs of the Exchange members, serves the stock exchange market of securities, repo and derivatives markets.

“Since 2010, the option of acquiring third-party technologies for IT modernization had been actively discussed at the

Exchange. After several discussions, in 2012 KASE decided to modernize IT using a team of its own specialists. They began with the currency market. In 2013, they started developing and in 2015, they launched the next-generation system, NEXT,” says Idel Sabitov³⁸. “The AST system has acquired a lot of functions and still operates in the stock and money markets. As experience was gained, the need to reduce the risks of non-settlement became more and more urgent. Now the AST system serves the T+0 and T+2 trading modes.”



Results of voting of KICSE shareholders for introduction of an electronic trading system, 1995

At the beginning of 1996, the Exchange was much stronger professionally and technologically, offering its customers the highest then possible speed and reliability of trading and settlements. That year was quite calm for the financial market and economy. The average annual KZT/USD rate was KZT 67.3 for one US dollar and KZT 13.7 for RUB 1,000. The 1996 Consumer Price Index was recorded as 128.7%, a decrease by 31.6 points versus the previous year. The index of manufacturer price of industrial products fell from 156.2 to 118.5% over the year. The total volume of export and import transactions amounted to USD 11.6 bn – a 9.4% increase over the year.

In 1996, the reformers saw with their own eyes how the non-inflationary mechanism of the state budget financing, to which the transition began in 1994, operated, and they checked on its efficiency. This was made possible by the launch of the domestic market for government securities. The volumes of placement of domestic government securities increased in 1996 from KZT 16.9 to almost KZT 63 bn, with a redemption volume of KZT 57.4 bn. The issue of government securities not only allowed solving the problem of non-inflationary financing of the budget deficit, but also became an effective means to regulate the circulation of money, “tying up” excess funds. The currency market got directly dependent on the government securities market, since it was through the currency market that the Kazakhstani tenge required for operations in the stock market was attracted. In addition, the proceeds from the redemption of government securities were invested through the currency market in foreign currency as an alternative financial instrument. Moreover, government securities, in particular, notes of the National Bank of Kazakhstan, were actively used as an instrument to regulate the exchange rate.

The well-balanced policy of the government and the financial regulator, which did not allow for any destructive actions for the market, such as concessional lending or memorable inter-offset, also determined the tenge exchange rate dynamics – smooth and predictable. This allowed launching trades in the USD/KZT term contracts in the financial market. Moreover, foreign currencies ceased to be an object of feverish demand, and foreign exchange transactions were made not only in order to serve foreign trade, but also based on saving and speculative tasks, including in conjunction with transactions in the government securities market. This was made possible not least because of the use of electronic entries and processing of orders on the Exchange and the use of dealing systems, such as REUTERS Dealing²⁵, by banks.

A trend, typical for 1996, was a reduced gap between the US dollar exchange rate index and the official inflation index and the producer price index of industrial producers. In 1995, it was 41.14 and 37.04 percentage points, respectively; in 1996, these values decreased to 13.78 and 3.58 percentage points. In 1996, for the first time over the past years, the gross domestic product grew by 0.5% compared to the previous year. The refinancing rate of the National Bank of Kazakhstan, which reached 450–480% in mid-1994, decreased by more than 20 times.

The obligations under Article 8 of the IMF Agreement undertaken by Kazakhstan in July 1996, which formalized the convertibility of the tenge for current transactions

and allowed the transition to a multilateral payment system, free from restrictions was a milestone as NBRK summarized the results of that year.²⁶ In the same year, Kazakhstan was one of the first of the CIS members to adopt the Program of Banking System Transition to International Standards in matters of asset classification, management quality, new accounting principles and chart of accounts, and trading in currency futures began at the Kazakhstan Stock Exchange.

For the Exchange, the development of interbank financial market instruments and the mandatory sale of a part of export earnings in exchange trading cancelled on August 4, 1995, resulted in increased competition with the over-the-counter market, whose total turnover of transactions in US dollars only was estimated by experts as USD 1,430,021,000. Further work to improve the quality of exchange services, the availability and attractiveness of the exchange was the response to that.

In 1996, the Exchange members in "B" category (with the right to participate in the trades in foreign currencies) were exempted from paying entrance membership fees and minimum guarantee fund contributions until the value limit of open positions of one participant was equivalent to one million US dollars. The new Rules for Exchange Trading in Foreign Currencies and the relevant settlement procedure were approved, which made it possible for each participant to use several correspondent accounts in foreign currencies at the same time with the existing settlement rate. Starting November 4, 1996, the Exchange switched to making settlements in the Deutsche marks in the "delivery-on-the-trading-day" mode and activated a correspondent account with Deutsche Bank AG²⁷.

The arrangement of settlements could not do without stressful events. On July 4, the Russian correspondent bank of the Exchange for settlements in rubles – JSCB Tveruniversalbank (TUB) – declared itself insolvent and suspended all internal and external settlement operations. However, according to Aigul Kaldybayeva, who was the head of the clearing house at that time, the Exchange had sent a warning letter about potential problems of the bank to the members of the Exchange the day before. That made it possible to minimize their losses and protect the Exchange from legal claims.

Not everyone took the warning seriously, and, according to the government, the total amount of funds of the Kazakh banks got "caught up" on correspondent accounts in Tveruniversalbank reached RUB 33–34 bn (ca. USD 6 mln). On July 8, 1996, the Exchange Council decided to cease trading in the Russian rubles and recommended the member banks of the Exchange to switch to settlements in tenge and freely convertible currencies with Russian counterparties. This story cost dear. The Exchange's dealing with the bankrupt bank helped to return only KZT 2.4 mln. The outstanding balance payable to the Exchange's members in the amount of KZT 12.5 mln was not repaid until November 1997 at the expense of commission fees, and trading in the Russian rubles on the trading floor was not resumed until 2000.

In 1997, the currency sector of the financial market of the republic was in more favorable conditions than in 1996. The financial authorities of the country possessed much larger resources, which made it possible to effectively regulate the level of devaluation of the national currency and control inflation. As a result,

FROM SPOTS TO FUTURES

In addition to the fact that the exchange market of foreign currencies was the sector of origin of KASE, it also provided a platform where stockbrokers started developing the market of term contracts. For the first time, trading in these instruments opened on May 15, 1996. These were three-month non-deliverable futures on the KZT/USD exchange rate. This type of contract made it possible to eliminate the risk of default in foreign currency, avoid the need for licensing, and also use it not only as a hedging tool for export-import operations and expected income in tenge, but also as a speculative tool. Five banks took part in the first trading – they made four transactions for the June futures.

“The USD exchange rate is probably the key financial indicator for many post-Soviet countries. A lot of contracts and loan agreements used to be attached to it. It always seemed to us that there was a natural environment to hedge and speculate on the rate,” says Damir Karassayev, who was CEO of Kazakhstan Stock Exchange CJSC from April 1999 to April 2002, to justify the emergence of this sector. “That’s why we took efforts to ensure that this product worked at the Exchange, and we, as a commercial organization, could earn on it, providing a demanded service. When we launched the first trading, not all traders understood how it worked. The essence of the tool is that when the rate changes, then the margin changes, which shall be kept under a contract. It was a complicated concept, but it developed slowly.”

Trying to increase the attractiveness of futures, the Exchange reduced the deposit margin rate from 3 to 1.5% and approved a preferential procedure for payment of entry membership fees for non-banking organizations to operate in this sector. That August, the Exchange launched trading in weekly dollar futures

hoping that it would attract traders who were afraid of a long-term speculation, and thereby serve as an incentive for the development of the derivatives market. However, only 20 transactions were made with ultrashort futures, and they were canceled early November.

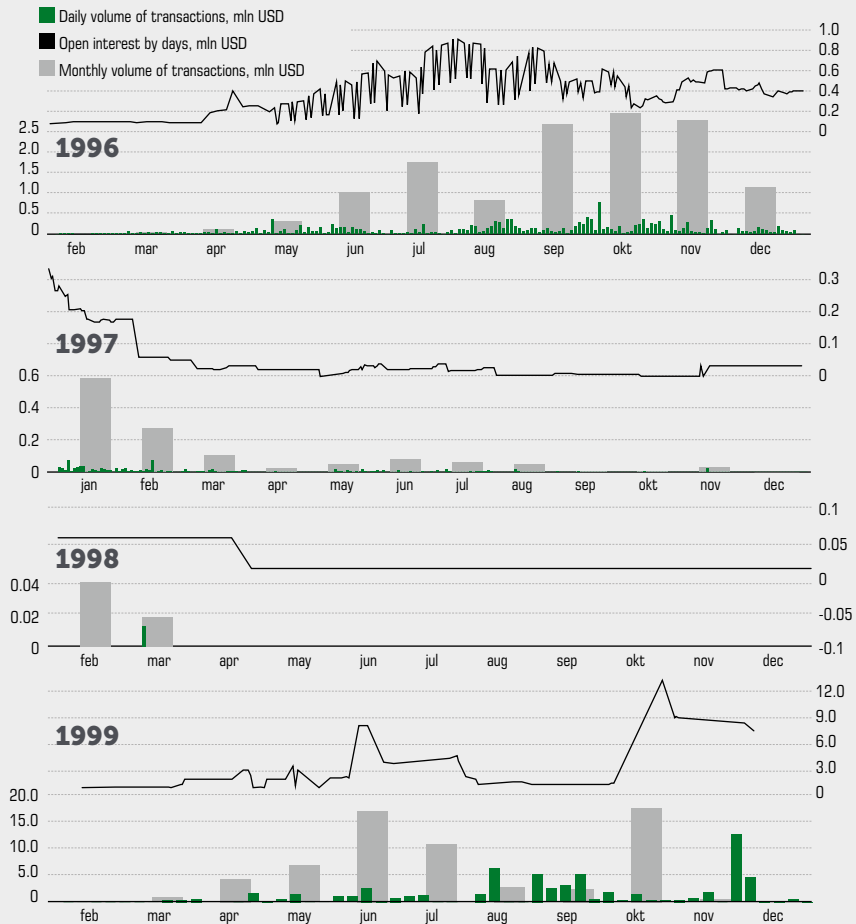
Trades in futures contracts and foreign currency were conducted by the double counter auction in the electronic trading system of the Exchange. In November – December 1996, when the USD/KZT rate zoomed up, the narrowness of the futures market did not allow the market participants to liquidate adverse positions with minimum losses, and many traders chose to leave this sector. As a result, as long ago as in 1997, the market turnover decreased by 9.3 times. The last contract was executed by the Exchange on August 13, 1998, and later traders showed no interest in transactions in this segment. In order to ensure maximum comfort for traders, the Exchange tried to make futures transactions at a particular time, combine them in one session with foreign currency, and conduct open outcry trading by the fixing method. But despite the aggressive marketing policy, no hedgers – clients of Exchange members interested in insurance of exchange risks in their foreign trade activities – came to the derivatives market.

The second attempt to arrange a new segment undertaken by KASE in March 1999 ended the same way as the first one. April 5, 1999 was a real test for the exchange market of term contracts. As a result of the big jump in the exchange rate of the underlying asset of futures, some derivatives market operators found themselves in a critical situation, which made the Exchange tighten the requirements for the market participants severely. Although the volume of open interest on the exchange futures platform sometimes

reached record levels for that time – USD 11 mln – in November 2000, KASE settled and closed the last position on the November term contract, and the

participants opened no new positions. Further attempts to “shake” this market at a new level were resumed only after the millennium.

VOLUME OF TRANSACTIONS AND OPEN INTEREST IN TERM CONTRACTS FOR THE PERIOD FROM 1996 TO 1999



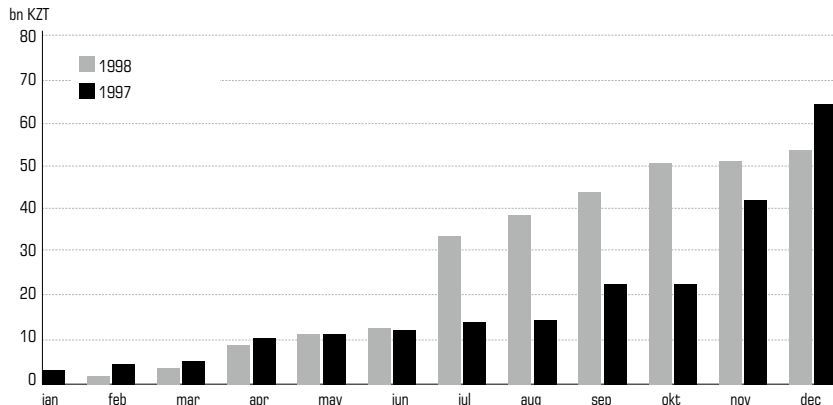
the dynamics of the market and discount rates of the tenge to the world's reserve currency stabilized even better, and from the second half of 1997 it was successfully predictable for several weeks in advance.

A certain role in stabilization was played by the entry of domestic financial structures into the international stock market and privatization. There were the conditions existing in the financial market of the country that, on the one hand, resulted in the reduced need of the bank customers for currency compared to 1996. On the other hand, speculation with non-cash freely convertible currency for the profit-making purposes earned much lower income to banks and bank customers rather than dealing with other financial instruments. The funds used earlier in this sector were allocated to the sector of foreign cash, operations with government securities, and to the market of loans and deposits. As a result, the turnover of not only the exchange currency sector, but also the over-the-counter one, decreased.

In its attempt to encourage traders to operate on its floor, the Exchange experimented with the terms of trade. For example, it introduced a differentiated commission – from 0.05% with a trading volume of up to USD 3 mln and 0.025% with USD 20 mln. This produced some results, since a part of the turnover from the over-the-counter market moved to the organized trading sector.

However, by the end of 1997, the first signs of the coming “storm” in the global economy appeared. Those symptoms were so clear that on December 26 the Exchange Council decided not to resume trading in the Russian rubles in the near future “due to the unstable situation in the global and Russian financial markets, as well as due to the existing objective factors on the implementation of guarantees by foreign correspondent banks”.

PROCEEDS TO THE BUDGET OF KAZAKHSTAN FROM PRIVATIZATION IN 1997–1998



Source: *Social Economic Situation of the Republic of Kazakhstan, January 1999*, operating data from the Statistics Agency of the Republic of Kazakhstan.

At the same time, they also determined the principles for setting limits on the sale and purchase of foreign currency without the obligation of advance payment and delivery for banks of the second and third groups operating on a prepaid basis. According to the report on the implementation of prudential standards of the National Bank of Kazakhstan on the last reporting date, the limit was set at the rate of 10% of the equity capital for banks of the second group, and 5% for banks of the third group. Generally, it became clear to the market that 1997 was the pre-crisis year.

FLOATING EXCHANGE RATE AS A RESPONSE TO CRISIS

The situation in the currency market of Kazakhstan in 1998 was less favorable compared to 1997. First of all, this was due to the influence of the global financial crisis, and the escalation of the Russian financial collapse from the second half of the year. The world crisis hit the prices for the Kazakh export products, 45% of which were mineral resources and 33% were metals. This fact could not have a positive impact on the stability of the national currency.

*The current head of the National Bank of the Republic of Kazakhstan **Daniyar Akishev**²⁸ says, "I worked in the Department of Research and Statistics of the National Bank at that time. The crisis was approaching, and we had to inform the leadership of the country and the government of what was happening in the world almost daily. We studied the causes of the crisis, prepared analytical notes. Now we already have a systematic look at such things. But at the time new information appeared daily – Thailand, Indonesia... Every country has its own specifics. We had to study and describe them all, since the crisis gradually affected an increasing number of countries in the region. We understood then that Kazakhstan could be exposed to this crisis due to its dependence on the economies of neighboring countries."²⁹*

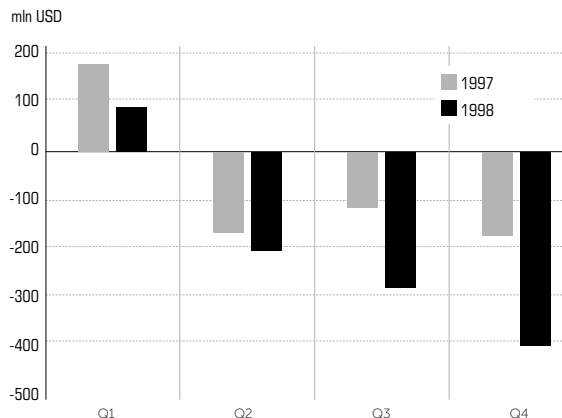
The main impact of the crisis resulted in imbalanced import and export flows. In 1998, the balance of trade of Kazakhstan was not in favor of the republic and amounted to USD 1,801.1 mln, and in 1997 it was USD 627.2 mln less. The increase in the negative balance was mainly due to a decrease in Kazakhstan's exports, which reduced in price terms as compared to 1997 by USD 1,252.6 mln. The volume of imports had not changed much. Initially, exports of products of a number of Kazakh enterprises to South-East Asia reduced, which led to a corresponding decrease in the volume of currency earnings to Kazakhstan. The situation was aggravated by the decline in world prices for oil and non-ferrous metals. In the second half of the year, the Russian factor developed at full.

In the domestic market, demand for the US dollar rose sharply. There were several reasons: the fall in currency earnings in the country, the peak in the fulfillment

of obligations by banks on large syndicated loans, the growth in the volume of servicing direct and publicly guaranteed foreign debt, estimated at USD 562 mln, and the slowdown in privatization rates. The events in the Russian domestic debt market made their contribution. They resulted in a temporary outflow of residents' funds from the domestic market late May – early June. Another factor was excessive demand from public and second-tier banks for freely convertible currency at the very end of the year caused by the anticipation of a sharp devaluation of the tenge after the election of the President of Kazakhstan. The effect of these factors provoked a sharp increase in the turnover of the entire interbank currency market – from USD 3,458 mln in 1997 to USD 4,913 mln in 1998. The rate of the tenge devaluation grew from month to month in spite of extensive currency interventions made by the National Bank. Affected by the crisis, the National Bank had to revise the budget rate of devaluation of the tenge at the end of the year and increased it to 9.6% per annum in order to protect the interests of exporters. At the same time, only in September 1998 the rate of tenge depreciation reached 27.8% per annum, and 8.3% per annum from the beginning of the year. It was only in October when it became clear that the most critical moment had passed. The measures taken by the National Bank (limiting currency positions, STB loans in cash US dollars to meet the demand of the population, a sharp contraction of the money base, including through the issuance of government securities) proved to be effective. From October 1998, according to the monthly trend, the rate of the tenge devaluation started declining steadily. The tenge finished the year with minimum losses for that time. However, as it turned out later, the stresses had been accumulating.

The 1998 crisis showed that the National Bank, the Exchange, and the financial market generally had to take unconventional decisions and take it from there. It is difficult to say how successful they were compared to other options – history

THE DYNAMICS OF BALANCE OF FOREIGN TRADE OF KAZAKHSTAN



knows no 'if'. However, it was obvious that they already managed to work in the changing conditions of the economy. The structures of the Exchange and the market were established, the processes were standardized, the protocols were registered, and a high degree of adaptability was evident. Suffice to say that already in mid-January 1999 trades in the KZT/EUR pair opened on KASE with a delivery on the day of transaction, and Kazakhstan became the second among the CIS countries after Ukraine to launch exchange operations in European currency.

The main test of maturity for the exchange mechanism was the introduction of the floating exchange rate (FER) of the tenge on April 5, 1999, which resulted in another round of the tenge devaluation (13.3% for a day – from KZT 88.30 to 100.01 per one US dollar, and on April 6 a surge up to KZT 138 was recorded). This devaluation was expected by specialists, but shocking for the population, since the tightening of monetary policy by the National Bank brought a lull – the situation in the domestic financial market had stabilized by the beginning of 1999. At least lay public thought so. Meanwhile, as Kadyrzhan Damitov, who headed the National Bank of Kazakhstan at that time, notes, soon after the Russian default, the dollar-to-tenge exchange rate almost tripled over a short period.

This led to a sharp disparity between prices in the domestic markets of Russia and Kazakhstan. Russian goods cost 3–4 times cheaper in tenge, accordingly, which led to an increase in imports and outflow of currency. The market got under pressure. It became clear that “we needed a more balanced decision in general for the economic policy in the new conditions”. In order to develop an algorithm of actions, a workgroup was established, the Economic Policy Council (EPC) was founded headed by the Prime Minister of the Republic of Kazakhstan. It also included First Deputy Prime Minister Oraz Zhandosov, and just few ministers.

*According to **Kadyrzhan Damitov**, “Many hot heads told us to set the exchange rate in proportion to the Russian one immediately, i.e. multiply by 4 – up to KZT 320 per US dollar. Some large exporting companies supported this idea. But what would have happened to the market, with the population, if we had made such a harsh decision? Therefore, the decision on the floating exchange rate in April 1999 was preceded by the huge joint efforts of the government, the ministries, and the National Bank. We worked together to stabilize the situation.”³⁰*

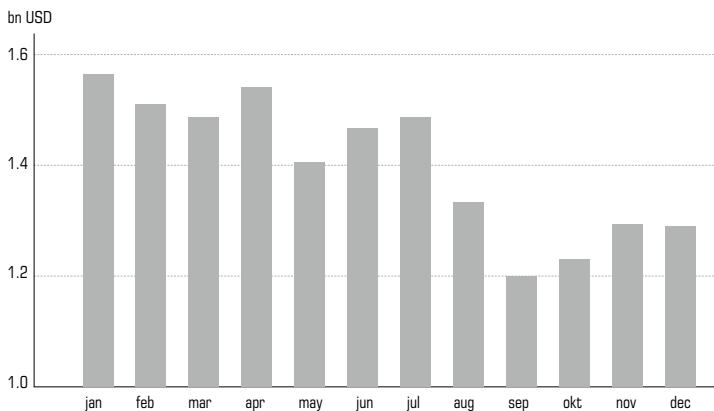
All possible scenarios were considered: a fixed exchange rate, a fixed range of exchange rates, a floating exchange rate; projected scenarios for the development of the situation were designed in respect of a particular decision. A kind of predictive matrix was made that incorporated all the key factors and showed the benefits of the transition to FER.

According to Mr. Damitov, “We assumed a limit of KZT 150. But it was important for us to understand how the market assessed the rate, whether those KZT 300 per US dollar we had been persuaded to set

would be “taken”. Someone tried purchasing for KZT 155 very carefully on the exchange trades in the first days. Just a thousand dollars was sold for this price. The rate was highly volatile for some time, and then the market calmed down more or less. Of course, the exchange offices had different prices. But the maximum exchange rate we knew about was KZT 200 per US dollar in some regions in the first days. It is worth noting that small volumes were traded on those days – they all tested what would happen. Then, when the trading participants and the population saw that there was no catastrophic situation, and the market rate got formed at somewhere around KZT 120, everyone who had been keeping dollars started dumping the currency. The National Bank, on the contrary, “collected the dumped”. Because if we had not assumed this line, the exchange rate would have slid back to KZT 100 again, but this would not have been a steady condition. The market started getting consolidated soon at KZT 115–117 per US dollar, with fluctuations in both directions. Thus, the National Bank set the rate based on the market fluctuations, looking at the market environment and the value of the currency prevailing in the course of trading. We did not set the course rigidly, administratively – we examined the situation and made an actual market decision. There were opinions that the rate should have been “released” before. But I consider such a delayed decision to be quite reasonable taking into account all the factors. It took time to understand that it was necessary to change the exchange rate policy.”

It was the first harsh lesson, and the first such a test, when it was no longer possible to rely on the “invisible hand of the exchange market”, but to make well-balanced reasonable decisions. Mr. Damitov says, “We started understanding that we should change the exchange rate fixing regime and link it to the general

THE DYNAMICS OF NET INTERNATIONAL RESERVES OF NBRK IN 1998



economic policy rather than move the currency "price." Therefore, we started analyzing the factors and combinations of such factors that should have been taken into consideration."

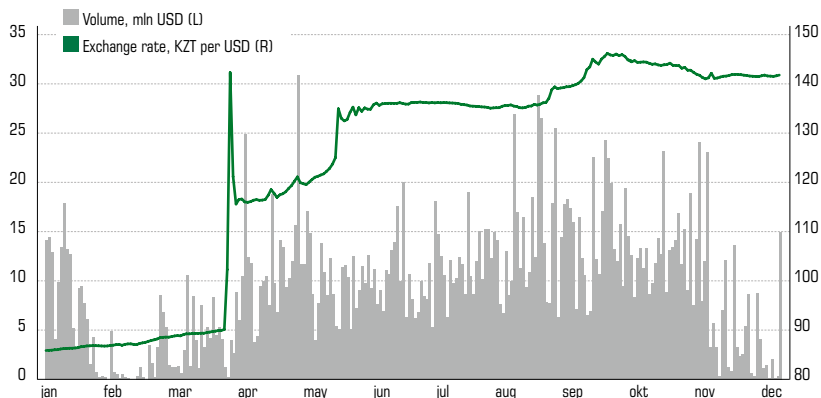
The transition to FER and the mandatory sale of half of the currency earnings of exporting enterprises at KASE introduced in this connection was the main factor that formed the overall environment in the currency market. At the end of the year, the tenge devalued against the US dollar by 64.6%. The weighted average exchange rate was KZT 126.59 per US dollar. The tenge weakened by 42.4% against the Deutsche mark. The weighted average annual rate of this currency was KZT 71.31 per Deutsche mark. As for the euro, the devaluation rate of the tenge reached 43.49% per annum by the end of the year, with a weighted average annual rate of KZT 140.73 per Euro.

In the 1999 market, there were several periods with their dominant factors. The first period – before the introduction of the new KZT/USD exchange rate – was typical for Kazakhstan: a very high pre-and post-New Year demand for the US currency resulted in a traditional "overheating" of the market at the end of January, and a decrease to the historical minimum value occurred in February.

During the second period – from the introduction of FER until late May: the currency market looked for a new level of equilibrium. By the beginning of June, when the US dollar exchange rate increased from KZT 115 to 130, the level of devaluation of the national currency was sufficient to achieve the market equilibrium and for the efficient use of the funds by export-oriented enterprises.

The third period was from May to September when the tenge exchange rate was stabilizing. The stabilization was due to the continuing rise in world prices for oil, copper, and other components of Kazakhstan's exports; introduction of a tax

THE DYNAMICS OF THE USD TO KZT EXCHANGE RATE AND USD TRADING VOLUME AT KASE IN 1999



monitoring system for the largest enterprises in the country; traditional low season in the market in summer; flexible strategies of the Ministry of Finance and the National Bank in the domestic debt market.

The fall in 1999 passed as usual, but its beginning was complicated by an excessive, as subsequent events showed, unreasonable rush in the currency market. It was caused by the demand for currency accumulated during the holidays, among other things. The devaluation rate in September was high, and the volume of trading in foreign currency on the Exchange was a record monthly turnover from the date of the tenge introduction.

The fifth period of the year was quite calm under the influence of positive news. The "tenge devaluation effect" played the key role in this period. It was by the end of the year when the republic saw the results of FER introduction... By the way, the strengthening of the tenge this time was caused not by the regulation of money circulation, but by an objective improvement in the real sector of the economy.

The 1999 results according to the National Bank, with Grigoriy Marchenko appointed as the Chairman in October, were described in the relevant press release. The main negative effects of FER were recognized, such as a 17.8% increase in the inflation rate; the increase in dollarization of the money turnover from 42.1% to 51%; the occurrence of a direct dependence of the value of government domestic borrowings on the changes in the exchange rate; deterioration of the loan portfolio of banks. On the other hand, positive results were as follows: a 1.7% national economic growth; the balance of trade was run a surplus of USD 344 mln for the first time over the last four years; the current account deficit decreased to USD 171 mln (1.1% of GDP); gross foreign debt reduced by USD 330 mln to USD 7,893 mln.

The year 1999 became the most important milestone in the history of Kazakhstan, because it was the first time when the market equilibrium exchange rate of the tenge was established. The market did its work; and the change limit of the US dollar exchange rate within the same trading session, which was canceled on April 6, did not have to be resumed. On the anniversary of the tenge, the National Bank finally canceled the mandatory sale of 50% of the currency earnings from exports on the Exchange.

The stabilization of the market allowed the Exchange to keep on improving the internal rules. On September 1, the Settlement Rules for Trading in Foreign Currencies³¹ came into effect. Trade participants were offered two methods of making payments in foreign currencies, they were: express delivery and limited sale. At the end of 1999, nineteen participating banks were switched to operation by the urgent delivery method. This allowed them to ensure enforcement of obligations by foreign currency selling banks online³² and thereby significantly reduce the risk of non-delivery of foreign currency based on the trading results.

On September 8, the Agreement on Participation in Exchange Trading through the REUTERS Dealing system was approved. A REUTERS dealing terminal was installed on the Exchange and the first transactions were made

using it. The orders were submitted to the terminal by a stockbroker on behalf of market players.

Early October 1999, the selling limits for the US dollars to banks, which did not use the express delivery method, were reduced by one third. At the end of November, an additional trading session in foreign currencies was opened – from 11:30 a.m. to 3:00 p.m. with settlements on the day of the transaction (TOD³³), and also the evening session from 2:00 to 6:00 p.m. with settlements on the following day (TOM³⁴).

* * *

Very dynamic and full of dramatic events: such was the first stage of the establishment of the fledging national currency and the exchange-based FX market of Kazakhstan. The tenge became the real symbol of the independent economy and stood up to reality within the shortest period of time by historical standards, whereas the currency trading sector has given the Exchange a strong basis for entering the emerging securities market.

FROM PAGER AND FAX TO ONLINE MARKET DATA

At the end of 1996, the Information and Analysis Department was established as a part of the Exchange, and four specialists from the information service of Semirechye private information agency, headed by Andrey Tsalyuk, were invited to arrange the operation of the Department. They had a task to establish the exchange information service capable of promoting events occurring in the financial market in an expert and understandable manner, ensuring informational transparency of the exchange market for leading media and specialized services such as REUTERS, Dow Jones³⁹, and BLOOMBERG, and delivering direct information services to the exchange partners. They also participate in preparation of KASE internal analytics and annual reports.

The Exchange's cooperation with REUTERS agency, which started in the summer of 1997, turned out to be highly effective in the information direction. And at the beginning of 1998, the Exchange started online transmission of trading information to the REUTERS terminals around the world in a semi-automatic mode from the beginning of 1998. Some pages of the terminal were filled out manually, and they used the REUTERS technology, which provided the links between the fields on the terminal pages and fields in Microsoft Excel files⁴⁰, that were in turn updated by the back office of the Exchange. In turn, the Exchange employees were provided with a free access to the REUTERS information product – Markets-1000.

An information hub was soon created at the Exchange. It had comprehensive data necessary for a technical and fundamental analysis of the financial instruments market in Kazakhstan. By 1998, the hub included 11 regularly updated main databases on The

Currency Markets and 18 databases on The Stock Market of Kazakhstan.

The established set of unique financial and exchange information containing historical data starting from 1991 allowed the market to present a number of popular commercial information products. They were delivered to customers via fax, paging terminals, and a mail and ftp servers of the Exchange.

The prospect of the informational line of business encouraged the Exchange to establish a subsidiary on the basis of the Department – IRBIS Information Agency of Financial Markets, which was officially registered on August 28, 1998. The idea was to separate the trading activities that the Exchange was engaged in as a then non-profit infrastructure organization, and the information business, thereby motivating the agency's employees to expand services. In addition to the Exchange, the founders of IRBIS agency included the Association of Securities Market Brokers and Dealers, the National Association of Securities Market Participants, and The Securities Market of Kazakhstan Magazine. In December, the agency was officially registered as a media with the Ministry of Information and Public Accord.

The most popular products of IRBIS were the KASE Broker Reference System set developed in the Windows Help environment, with an option of remote updating via electronic communication channels; information and analytical review Exchange Stock Market Week; and the information series adapted for paging communication dedicated to monitoring the entire stock market of Kazakhstan.

The informational support of the online presence of the Exchange on the Internet took a particular place in the operation of the Exchange from October 1997.

At the beginning of January 1998, the first KASE website, kase.kazecon.kz, was launched and was fully supported within the USAID⁴¹ project Stock Market and Privatization in the Republic of Kazakhstan.

In November 1999, in cooperation with Actis System Asia, the Exchange proceeded to the development of a new official website of KASE – The Music of Financial Instruments (www.kase.kz). A special feature of the website, which started operating in March 2000, was the online visualization of all trades and

an extensive regularly updated database of issuers of securities and their financial statements, Exchange members, traded financial instruments and news in two languages with quick access to the archive.

The innovations were well received by the market. The website won in the category The Best Business Website KITEL 2000. KASE reinstated to be the center of financial information and the best advanced high-tech continuously improving structure in the stock market of Kazakhstan.



The first KASE website, kase.kazecon.kz, 1998



KASE



Chapter 2

WHERE THE MARKET IS BORN

FALSE START OF THE GTB MARKET AND THE STRUGGLE
FOR THE STATUS OF A MODEL EXCHANGE

UNDER THE FLAG OF BLUE CHIPS

GS RETURN AND LAUNCH OF THE DOMESTIC
EURONOTE MARKET

FLOATING EXCHANGE RATE AND SECURITIES MARKET

ON THE EVE OF A BOND BOOM

Chapter 2.

WHERE THE MARKET IS BORN

The transition of Kazakhstan to a market economy also meant the inevitable emergence of key market institutions. Such as the securities market, the stock exchange. But if for the first year after its establishment, the Kazakh Interbank Currency Exchange operated exclusively in the currency market, then in August 1994 its management and shareholders raised the issue of entering the securities market. The KICE made its first step from a currency exchange to a universal exchange, which it is today, on July 12, 1995, when it was re-registered as the Kazakhstan Interbank Currency Stock Exchange. The exchange moved to a new stage of development, where much was to be done for the first time in the history of independent Kazakhstan. Although by that time Kazakhstan's securities market was already "inhabited" and KICSE was entering a competitive field...

The first securities legislation appeared in Kazakhstan in 1991. In accordance with the Law of the Kazakh SSR *On Securities Circulation and the Stock Exchange*¹ with just 14 articles, the Ministry of Finance of the Republic exercised control over the issue and circulation of securities in Kazakhstan. The first securities issuers began to appear in 1991–1993, when, after the adoption of the Denationalization and Privatization Program², which identified the incorporation as the main form of privatization, private property rights were first consolidated.

The boom of the stock exchanges and numerous financial intermediaries took place at the same time. For the period from 1992 to 1994, the Ministry of Finance issued a total number of licenses for professional activities in the securities market to 1,460 individuals and 98 legal entities.

The activity of most of these exchanges and intermediaries were quite far from the classical understanding of operation in the stock market. In fact, they served the struggle for control over joint-stock companies founded in the course of privatization, including through the buying up, redistribution and concentration of originally acquired property rights. However, the new owners of enterprises were quite dismissive of the need in state registration of securities issues. As a result, the majority of joint-stock companies that had appeared in Kazakhstan in the course of privatization did not exist in a strictly legal sense, since the issue of their shares was not registered.

Most joint-stock companies to work with the civilized securities market. The market launch was hampered by negative trends, such as high inflation rates, which quickly devalued money and encouraged the enterprises to attract unsystematic borrowed resources, as well as production stagnation, which made

Kazakh enterprises completely unattractive for investors, and the significant dominance of the public sector in the economy structure.

In general, 1991–1994 can be viewed as a “training” period for the non-government securities market, by the end of which the government got a clearer idea of what the infrastructure of the stock market should be like. On March 20, 1994, the Decree of the President of the Republic of Kazakhstan *On Measures to form the Securities Market*³ was issued, in accordance with which the National Securities Commission (NSC) of the Republic of Kazakhstan was established.

When recalling how the National Securities Commission was established, **Gulzhana Karagussova**, the Chairperson of the Finance and Budget Committee of the Mazhilis of the Parliament of the Republic of Kazakhstan, said:

“In May 1994, I was invited to work as an assistant to the President of the Republic of Kazakhstan, Nursultan Nazarbayev. I did not leave the idea of developing the securities market and argued that we still needed to make a securities market. We discussed this issue a lot with the President N.A. Nazarbayev. As a result, the Head of State proposed the creation of the National Securities Commission.

The main goal of the National Commission was to build the securities market correctly. In 1995, by decree of the Head of State, the National Commission was established. In 1996, N.A. Nazarbayev appointed me as its Chairperson. By introducing the Law On the National Securities Commission of the Republic Kazakhstan, as was the case in most developed countries, the National Commission was supposed to be independent from the Government, but reporting directly to the President of the country. Because the Government itself is the entity of the financial market.

The document was not signed for a long time, but as a result, the Regulation on the National Securities Commission of the Republic of Kazakhstan was approved by Governmental Decree No.370 of March 28, 1996. The first paragraph of the document stated that the commission “is the central executive body that is not part of the Government of the Republic of Kazakhstan.”⁴

At that time the issue of establishing the Central Securities Depository was raised for the first time. Later, on October 3, 1994, the Government issued the Provisional Regulations on Securities and Provisional Regulation on the Issue and Circulation of Securities and the Stock Exchange⁵, which detailed the processes of issuing and circulation of securities, introduced licensing of stock exchanges, and included depository activity in the list of types of professional activities in the securities market.

The year 1994 was also the starting point of the government securities market in Kazakhstan. The National Bank started reducing functions, which were irrelevant to central banks, in favor of the classical ones – it started granting loans to the Government to cover the budget deficit not at a preferential rate, but at a refinancing rate. The Ministry of Finance began switching to non-inflationary

methods of financing the budget deficit. On April 4, 1994, the first auction of government securities took place; the Ministry of Finance was the issuer of such securities. The securities were three-month government treasury bills (GT-Bills)⁶. The National Bank was entrusted with placing and servicing government securities issued in circulation, and with its consent 20 banks obtained a license from the Ministry of Finance to conduct transactions with securities. In the first six months of the year, securities auctions were a rare thing, no more than once a month, but by the end of the year they were held weekly.

They were held by the National Bank outside of any stock markets, using a subscription system through the collection of requests filed by banks in a documentary form. Then, the government securities market of the Ministry of Finance showed tremendous dynamics: if in 1994, sales of government treasury bonds with a maturity of 3, 6 and 12 months amounted to KZT 367.2 mln, in 1995 it already reached KZT 10.5 bn, having increased by 29 times, and in 1996 it rose to KZT 30.3 bn. At the same time, the Ministry of Finance introduced a new type of securities to the market in 1996 – the National Savings Bonds (NSB), initially targeted to be purchased by the population and placed by authorized banks under the terms of hard underwriting. In 1996, they managed to place NSB for KZT 0.55 bn, and their yield was tied to the results of synchronous primary auctions for the placement of GTB-3.

In addition, in 1995, the National Bank started issuing its bonds – notes that received the status of government securities. The notes were a very short instrument with a maturity from one to several weeks and were used exclusively to regulate the amount of spare cash in the market.

These trends did not go unnoticed by the management and shareholders of the Kazakhstan Interbank Currency Exchange: as early as in August 1994, the Exchange Council instructed the Exchange Management Board to start working on the development of exchange services in the securities market. So that the name of the Exchange fully reflected new lines of activities, the General Meeting of Shareholders decided to change the name of the Exchange to Kazakhstan Interbank Currency Stock Exchange (KICSE).

FALSE START OF THE GTB MARKET AND THE STRUGGLE FOR THE STATUS OF A MODEL EXCHANGE

The country had already begun privatization. It was an active search for a mechanism for the privatization of enterprises. Various options were considered. *Gulzhana Karagussova* was a supporter of privatization through the exchange.

"In the period of my work, most enterprises were privatized through the stock exchange," Gulzhana Karagussova recalls the period of her work at NSC.

"We tried to do everything based on the international standards: a register was created, we conducted training, we had a corporatization commission. We all, including the Chairperson of the National Commission, went to the regions, talked to people, told them how to become the owner of the enterprise through the Exchange. International experience showed that 70% of the entire developed securities market consisted of investing individuals. And we needed to get people interested so that they wanted to become owners.

Not all projects were successful, but it can be definitely said that the new period of the first stage of privatization went all the way through the Exchange. And it was specific that people were attracted by the first wave of real privatization. Both in Almaty and in the regions there were successful examples. For example, Rakhat confectionary factory, where they immediately decided that the shares would be repurchased at the price formed at the time of the repurchase, and most was purchased by the team. Moreover, no exchanges – just money."⁷

KICSE's plans for the securities market came true in 1995. Moreover, it relied on the government securities as the best meeting criteria for the stock market, such as legitimacy, liquidity and profitability.

The Exchange developed the rules for trading in government treasury bills and treasury bonds of the Ministry of Finance. The work was carried out by the Exchange Council, whose competence included: making a decision on admission of the Exchange members, developing and approving the rules of exchange trading, determining the amount of commission fees charged by the Exchange, organizing work and monitoring the activities of the Clearing House. However, the decision was a joint and market one, since EC was comprised of representatives of the shareholders.

The Exchange also agreed the procedure for settlements in government securities with the authorized depositories – the National Bank of Kazakhstan and Kazkommertsbank Joint-Stock Bank. The terms of the exchange membership were also clarified with a division into two categories: B – with the right to participate in trading in foreign currencies and K – whose members got the right to participate in trading in GT-Bills.

On September 29, 1995, the Exchange received a license from the National Securities Commission of the Republic of Kazakhstan No.1 for the arrangement of trading in government treasury bills. On November 14, the first trading in these securities took place. For the organizational purpose, an electronic bid entry and processing system was used, time-tested by the Exchange for currency trading and modified to reflect the multiple nature of the GT-Bills issue. There were four trades in GT-Bills in 1995 for a total amount of 5.5 mln KZT.

However, the exchange segment of the government debt market was not properly developed at that time. The few participants in the secondary GS market were not interested in its informational transparency and preferred to search for counterparty directly, using the service of the National Bank as the GS depository to register their transactions. Exchange trading in government bonds was episodic, irregular, and a year later, on September 20, 1996, the Exchange had to cease such trading.

It became clear that neither the Ministry of Finance's securities sector, nor the National Bank's bond segment, which appeared in 1995, did not solve the problem of establishment of a proper stock market, since corporate securities should circulate in such market for due economy financing. In this connection, during 1995, the existing infrastructure of the NGS market was analyzed at the state level. The rating was identified and it was unsatisfactory.

Therefore, on March 28, 1996, the Government Resolution approved the Program for the Development of the Securities Market⁸, which, among other things, provided for a tender to select a model stock exchange from among those existing in the market. The winner was promised to get state support in the establishment of a civilized exchange market meeting international standards, as well as holding trading in government securities and government blocks of corporate securities to be privatized.

By that time, the NSC licenses for exchange activities in the securities market were held by three exchanges: the Central Asian Stock Exchange (CASE), the Kazakhstan Interbank Currency Stock Exchange and the International Kazakhstan Stock Exchange (IKSE). It was clear that only a mature unstagnant stock market meeting the technical specifications of that time, compliant with the legislation, supported by the shareholders could take the lead in the coming years and take a priority position in the market, pressing or completely forcing competitors out of the market.

Joining this competition, on April 12, 1996, KICSE went through a state re-registration to change its name to Kazakhstan Stock Exchange (KASE) as required by the updated legislation and NSC's recommendations. On July 31, 1996, the Exchange Council approved the new Rules for the Exchange Trading in Securities and appendices thereto, including the Regulation on Securities Listing, and later, on September 13, the Procedure for Settlements on Non-Government Securities. These documents were necessary to obtain an unrestricted license to conduct exchange activities in the securities market, which was issued to the Exchange on November 13.

*"The things were difficult," admits **Azamat Dzholdasbekov**, who held various positions on the Exchange from 1995 to 1997 – from a consultant to acting Director General. "For example, how the regulatory framework for the stock market was created: in 1996, we had no shares, no bonds, but the Exchange existed as a market. And it should have rules. That means the car may not yet go, but it should be absolutely ready – built, cleaned, filled. And if there is a need, then you can start it and go any time. It was the same with the Exchange – the rules were written – the first listing requirements for the future movement, although there was still no clarity on how this movement would look like in practice. Listing requirements are currently dozens of pages in small print about what a company should do to meet them. However, there were not even any characteristics common for all companies that could be used as a basis for listing requirements, starting with accounting standards, not to mention the audit of financial statements..."*

On October 29, an inspection of the Exchange trading systems was completed by expert teams of the Ministry of Finance, the National Bank and NSC that highly appraised the Exchange's equipment and technologies.

On December 24, Exchange Councils of KASE and IKSE signed a joint resolution to merge the exchanges to participate in a tender for the status of a model exchange with the subsequent termination of the exchange activity by IKSE. Given this merger, on December 31, 1996, KASE was recognized as the winner of the tender.

Although by the end of 1996, there were two competing stock exchanges – CASE and KASE – in the securities market, the position of the latter strengthened significantly after that winning. The model exchange actually acquired the status of a key link in the stock market infrastructure. The next year showed it.

UNDER THE FLAG OF BLUE CHIPS

In December 1996, two more events took place that aroused investors' interest in the Kazakhstan stock market for almost two years: the Government adopted the Regulation On Measures to Intensify Exchange Trading in Securities⁹ on December 14 and On the Approval of the Lists of Economic Entities, whose Portions of the State-Owned Blocks of Shares to be sold on the Stock Exchange¹⁰ on December 31. A little later, the measures provided for by these resolutions got the code name Blue-Chips Program. Grigoriy Marchenko¹¹ was its main initiator and implementer, who took the position of the Chairman of the National Securities Commission of Kazakhstan in November 1996, replacing Gulzhana Karagussova¹² in this post.

*In his book, *Finance as Creativity: Chronicle of Financial Reforms in Kazakhstan*¹³, **Grigoriy Marchenko** recalled later, "I thought that the development process of the corporate segment of the national stock market should be stimulated simultaneously from both sides by pushing both sellers and buyers to enter the market. The idea of how to achieve this goal arose back in the period when the concept of the pension system was under development. It was supposed, first, to stimulate "demand" through the establishment of accumulative pension funds, i.e. to push the establishment of a class of institutional investors (it is a well-known fact that pension funds (and life insurance companies) are the owners of the longest-term money everywhere in the world); second, to stimulate "supply" by privatizing a portion of the state-owned blocks of shares in large national companies, a certain percentage of which will then be released to the stock market, i.e., to help the occurrence of a mass issuer; third, by matching "supply" and "demand" to stimulate the development of the stock market... The planned design was quite clear and correct – companies would sell part of their shares on the Exchange, pension funds would buy such shares, the stock market would grow, various categories of investors would enter the stock market, the economy would get investment, the entire population would benefit from the economy growth.*

It was about the appearance of shares in the market as such. That means it was necessary to privatize a certain number of fairly large companies. I suggested starting with the best enterprises of Kazakhstan that had good chances to become national blue chips.”

The framework of the proposed concept clearly highlighted the new outlines of the stock market. In March 1997, two main Laws were adopted – *On the Securities Market* and *On Registration of Securities Transactions in the Republic of Kazakhstan*¹⁴. Based on these Laws, in the first six months of the year, the Government approved a package of regulatory legal acts regulating the licensing and professional activities in the securities market, such as broker-dealer activities, custodian activities, activities of the Central Securities Depository, and maintaining a register of holders of securities.

In the summer of 1997, following a tender, where the joint bid of the National Bank and KASE won, Central Securities Depository CJSC was established, which became the core of the technical infrastructure of the stock market together with the Kazakhstan Stock Exchange based on the recommendations of the Group of Thirty – the actual international standard in the area of securities settlements. Bakhytzhan Kapyshev, who participated in the software development for a depository of government securities at the National Bank’s assignment together with Aben Bektasov, Yekaterina Ivchenko and Andrey Karyagin in 1993, became the head of the Central Depository.

*According to **Azat Nukushev**, who held the posts of KISE Deputy Director General and then the President of the Kazakhstan Stock Exchange from 1995 to 1999, “I was lucky to become one of the specialists and managers involved in the establishment of the stock market in our country. Our task was to create its infrastructure: Exchange, Depository, registrars, reliable transaction settlement system, etc. And, of course, participate in the creation of the entire regulatory framework of the stock market... The Exchange’s methodological and process readiness, personnel and technical support were at a sufficient level. This allowed us to conduct electronic exchange trading from the first days, to ensure a stable and prompt system of cash payments against the delivery of securities. If something was missing, it was quickly caught up. I would like to particularly mention the great assistance of the National Bank of the Republic of Kazakhstan.”¹⁵*

Professional market players got enthusiastic as well. In the second six months of 1997, a number of brokers-dealers started growing intensively and lasted until 1999; the registrar industry was created from scratch, the first custodian banks appeared.

The most important event that occurred in 1997 and predetermined the development of the securities market of Kazakhstan for the following years was the adoption of the Law *On Pension Provision in the Republic of Kazakhstan*¹⁶. According to it, an accumulative pension system should be introduced in the country in 1998.

Stockbrokers were actively preparing for the appearance of shares of corporate issuers in the market. The lists of KASE's members added H category, which gave the right to trade in non-government serial securities. The listing requirements were revised and adopted, providing for four levels of NGS approval for trading, such as official lists of A and B category securities, the Additional List of Securities, as well as the Non-Listing Securities sector.

Unlike CASE, which specialized mainly in state-owned blocks of securities offered by the Government for sale as part of mass privatization, the KASE listing initially focused on blue chips, the shares of the largest companies in Kazakhstan, which determined the country's economic situation.

The requirements for issuers at KASE were difficult to meet at that time. The process of including shares in trading lists of the Exchange was very slow and difficult. The managements of many joint-stock companies were reluctant to provide the necessary information on the current condition of their enterprises and very sensitive about the requirements of the Exchange to disclose information in the required scope. In addition, as practice showed, the process of switching to new accounting standards and conducting a comprehensive international audit took quite a long time.

The bankers were the most "savvy" in this issue by that time. It was not surprising that the first corporate securities, which opened the trades on KASE on September 19, 1997, were the shares of Neftekhimbank SB OJSC¹⁷. The only company, whose shares were listed in A category, was Kazkommertsbank OJSC, which had already entered the foreign exchange markets with its ADR and GDR.

By the end of 1997, 24 types of shares of 13 companies were listed on KASE. Three state-owned blocks of shares were admitted to trading as part of mass privatization. The trading volume for September – December amounted to 72,382 shares and one state-owned block for a total of KZT 175,522,000, and the securities market capitalization of KASE reached KZT 101.3 bn.

As new shares were added to the lists of securities of the Exchange, the activity of trading participants increased and reached its maximum in November, when 20 transactions were made for a total of KZT 126.3 mln, or 72% of annual turnover. Following the results of 1997, the companies, whose equity securities turned out to be the most liquid ones, were determined at KASE – Kazchrome TNC's ordinary shares were the leaders in absolute volume (45.5% of the total trading volume, although just a single transaction was made), and preferential shares of Kazakhtelecom JSC and Mangistaumunaigas JSC by the number of transactions – 17 and 16, respectively.

Everything seemed to be going well, and the exchange flywheel – though not without effort – began spinning faster and faster.

Meanwhile, a serious discussion ran high about the blue-chip program in policy circles of Kazakhstan. Opponents of privatization through the exchange produced a variety of arguments, such as social justice (giving the shares in blue chips at a discount to ordinary Kazakhstanis rather than selling them to foreign portfolio investors), the practice of loans-for-shares auction in neighboring Russia (borrow money for the development of enterprises from banks against state-owned blocks

of shares instead of selling out assets) and even the wrong time for it (they said, a couple of years later those companies would cost more)¹⁸.

Gulzhana Karagussova also shared her opinion on the program:

"When the market was just developing, in my opinion, there were a lot of erroneous or hasty actions. For example, the idea of "blue chips", which they decided to launch in 1997. It was just before the crisis; we could hardly take a breath and were recovering the economy and state institutions...In general, this was the right idea, but in order to implement it, it was necessary to create strong, high-value enterprises to enter the stock market, so-called "blue chips". But there were no such enterprises in the country at that time, and the state of the economy was post-crisis."¹⁹

The Asian crisis, which began in the second half of 1997, although it had not yet directly affected Kazakhstan by that time, did not add confidence to the Government in this matter. In the end, they decided to freeze the program.

After the announcement of Government Decree No. 1558 of November 15, 1997, *On the Results of the Investment Tender*, which provided for the suspension of the sale of state-owned blocks in a number of major companies to portfolio investors, the activity of the NGS market started falling rapidly and dropped to a minimum by the end of December.

The National Securities Commission and the Kazakhstan Stock Exchange worked on the blue-chip program. They prepared four Kazakh companies to enter the stock exchange – Aktobemunaigaz, Mangistaumunaigas, Kazakhtelecom, and Kazzinc. ABNK AMRO Bank was one of the banks that worked out the possibilities of their introduction to the stock exchange; they worked out the issues with investors, studied the requirements and conditions of placement on KASE. The Exchange was ready for this from technical, legal and professional point of view. There was already the market infrastructure: it was made up by the Exchange, brokers, underwriters, depository, and registrars. USAID, the World Bank provided great assistance in program development. The target volumes of sales of shares were quite small compared to current standards, since the capitalization of companies was low. Thus, according to the estimates, Kazakhtelecom cost USD 250 mln.

Recalling this work, **Umut Shayakhmetova**, Chairperson of the Management Board of Halyk Bank of Kazakhstan JSC, then working for ABN AMRO Bank, said:

"Everything was relative to its time, and everything was possible. Unfortunately, this project did not happen in spite of the great interest among international portfolio investors and our local investors, first of all, pension funds. It was a good opportunity to bring attractive companies to the Exchange and make the privatization process more transparent. I believe if privatization followed the way of selling shares through the Exchange, the economy could have developed according to a different scenario."²⁰

GS RETURN AND LAUNCH OF THE DOMESTIC EURONOTE MARKET

The beginning of 1998 was marked by serious tectonic shifts in the Exchange landscape of the country. In February, CASE's license was suspended for 30 days and revoked upon expiration of this period. The NSC's decision was based on CASE's failure to comply with the new legal requirements. As a result, in 1998, KASE turned out to be the only stock exchange in the country.

The main event of the year was the emergence of eight pension asset management companies (PAMC), including the National Bank acting as the investment manager of the pension assets of the State Accumulative Pension Fund (SAPF). Serving 13 APFs with total assets of KZT 23.5 bn²¹, they very quickly became the largest institutional investors in the securities market of Kazakhstan. First of all, government securities, because the only no-less-than limit for the portfolio structure was set to PAMC for GS. Investment limits for other instruments were designed according to the no-more-than principle.

*"The reform of the pension system was necessary, because the solidary system went bankrupt," says **Grigoriy Marchenko**. He expressed his point of view on the events that took place twenty years ago in his interview to the Kursiv newspaper²². "Many people have forgotten about it, but in 1997, delays in the payment of pensions were as long as six months, and the total arrears in the payment of pensions amounted to about USD 0.5 bn in equivalent. For our country, this was a huge amount. Many people have also forgotten that pension reform had two stages. The Parliament decided to increase the retirement age in 1996, and at the same time it was decided to establish voluntary accumulative pension funds. At that time, I worked as the Deputy Chairperson of the National Bank, who was responsible for supervision, and we were in charge of implementing the reform. We studied pension systems for half a year from all sides and came to the conclusion that voluntary funds would not solve the problem of future pensioners. At that point, several countries were thinking over a pension reform: Kazakhstan, Kyrgyzstan, Russia, and Ukraine. Kyrgyzstan established a voluntary pension fund, and now 21 years later, it became absolutely clear that it did not solve any problems. I then prepared a note addressed to the President, handed it to the Chairperson of the National Bank Oraz Zhandossov. He corrected it and handed it over to the Head of State. Then I had another meeting to explain the details, after which the President instructed the Government. It was November – December 1996. After that, we came up with a draft law in the Parliament. There were a lot of discussions on this topic in the Mazhilis.*

Pension reform is a joint merit. The main thing was that we had the political will, plus the support from the President and the Government. By the way, then the Prime Minister made the representatives of all the ministries and the

National Bank sign the document. There were about twenty people present. He then said: if after 20 years someone asks who made the reform, the names will be known. More than 20 years have passed – we did everything right.”

*“The implementation of the pension reform was a serious driver of the development of the market where money appeared, a whole class of domestic investors appeared who needed to buy publicly traded assets,” said **Damir Karassayev**, who chaired KASE from 1999 to 2002. “At the very first stage, I believe, adequate regulation of the investment activities of private pension funds was laid. One of the forms of quality control of the APF management was access to the stock exchange. In this regard, the Exchange focused on creating high-quality selection procedures for companies to be listed. In general, the regulation was built on encouraging APF to buy securities, fixed-income instruments.”*

If in 1994, when the foundations of the GS market of Kazakhstan were laid and the first treasury bonds appeared in circulation, the Government primarily focused on the banks in the issuing, as the only institutional investor in the country, the situation changed at the beginning of 1998. A new institutional investor began to emerge in Kazakhstan – APFs that had to invest at least 50% of their assets in GS of the Ministry of Finance and the National Bank. And it could not have come at a better time.

The fact that the GS market, which relied only on banks, was very sensitive to various fluctuations in the market environment was clearly demonstrated by the impact of the Russian crisis on Kazakhstan. When the Russian government, under the influence of the Asian crisis, tried to save the government debt pyramid and raised the yields of its domestic bonds to 140% per annum, the Kazakh banks stopped buying MEKAM and preferred the Russian market in the first six months of 1998. The Ministry of Finance of Kazakhstan lost the demand for GS from the main investor, but behaved carefully and did not follow Russia in significant rise of the yield of its securities. The August events of 1998, when Russia – for the first time in the world – defaulted on domestic government bonds, caused the non-residents to leave the Kazakh market. The Kazakh banks, although they “came back home”, did not show much interest in devaluation non-indexed MEKKAM and notes with a tripled rate of KZT/USD devaluation and tried to bring pressure on issuers to reduce the price for bonds issued.

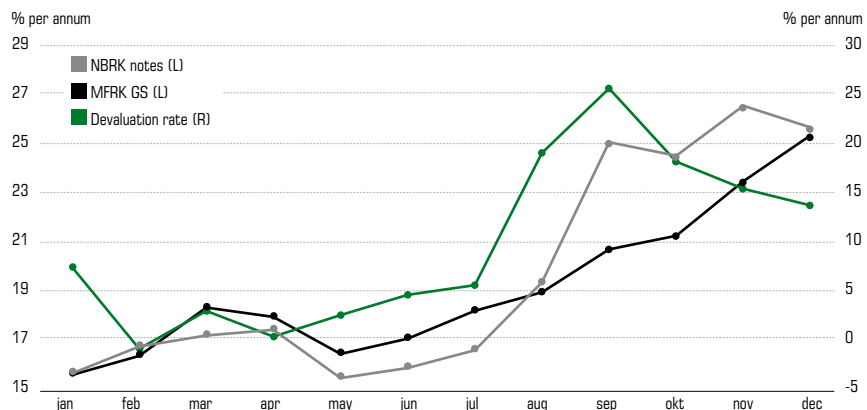
It was when APFs, which had already gained strength and were controlling up to 30% of the total domestic government debt issued in the form of GS, appeared to be very useful. Their demand strongly supported the Ministry of Finance. KASE was also ready to take over the entire secondary GS market, ensuring its full transparency and equal opportunities for all potential investors when working in the market. The 1998 results could give clear evidence to this fact. Having reopened trading in GS in February, the Exchange brought the volume of transactions in GS from KZT 133.9 mln that month to KZT 7,055.7 mln in December. The share of the exchange component of the entire secondary market of the country grew from 0.5% to 33% for the eleven months of 1998.

APFs and PAMCs played a key role in the emergence of the domestic market of sovereign bonds of the republic as well as in pricing of such bonds in the international market.

According to **Azamat Dzholdasbekov**, who held key positions at the Kazakhstan Interbank Currency Stock Exchange and Almaty Financial Instrument Exchange (AFINEX) from 1995 to November 1997, "In 1998 everyone admitted that the Blue-Chips program did not work. But the accumulative pension system did. Moreover, when the global financial crisis broke out, it allowed Kazakhstan to maintain its reputation as an issuer. At that time, with falling Russian securities and Asian markets, the prices for Eurobonds of Kazakhstan (these were the first issues) dropped much as well. Then, as a matter of urgency, the three government agencies joined efforts – the National Commission equated investments in Eurobonds with investments in government securities; the National Bank confirmed that the purchase of Eurobonds did not constitute capital export; and the Ministry of Finance clarified that the purchase of Eurobonds did not entail any tax liabilities, because income from government securities was fully exempted from taxation. The Kazakhstan Stock Exchange together with the Central Securities Depository promptly agreed on how to re-import Eurobonds back to Kazakhstan. A channel was opened, and domestic APFs instantly bought up all Eurobonds of Kazakhstan. Based on the results of 1998, the Kazakh pension funds showed a yield of 30% in foreign currency. It was the first and only record, still never broken."

Indeed, Russia's default on foreign borrowings led to a collapse in prices for Euronotes of Kazakhstan. The "net" prices for the sovereign bonds of the first

EFFECTIVE AUCTION RATE OF GS AND KZT DEVALUATION RATE IN 1998



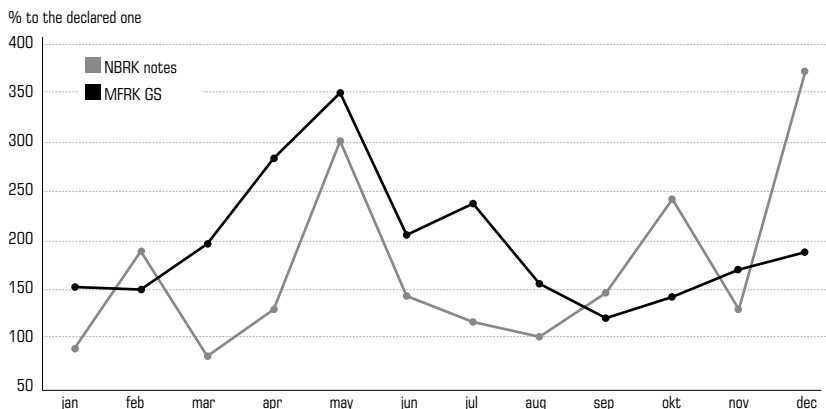
and second issue reduced by 1,500 and 4,000 percentage points during August. As a result, the bonds of the Ministry of Finance of Kazakhstan gave the investor a much higher return in the international market than in the domestic one. On the other hand, in August 1998, under the influence of the Russian crisis, the rate of devaluation of the national currency of Kazakhstan increased significantly, and the need of domestic investors for a financial instrument to protect invested funds from devaluation became particularly acute.

In this regard, at the end of September 1998, KASE together with the NSC began preparing the bringing of Kazakh Euronotes to the domestic market in order to offer this financial instrument to investors and, above all, PAMCs. With the help of professional market participants, a scheme of custody and accounting of Euronotes, a transaction settlement system and quoting methods for Euronotes in the trading system of the Exchange were developed and implemented.

On October 5, the NSC Directorate issued Resolution No. 158 *On Transactions with International Government Securities of the Republic of Kazakhstan*²³, which provided for mandatory registration of transactions involving pension assets at KASE and that the transactions should obligatorily be made only in the stock market, if residents of Kazakhstan acted as counterparties.

The first transaction with Euronotes of Kazakhstan with the APF assets involved was registered in the over-the-counter market on October 19: one of PAMCs made a transaction in Euronotes KAZAKHSTAN-99 in favor of the fund in the amount of USD 290,500. The buyer's rate of return amounted to 28.417% per annum. At KASE, trading in Euronotes was launched on October 19, 1998, and the first exchange transaction was made on October 23. Trading participants had the opportunity to work both in the automated mode and in the mode of indicative quotations to make transactions. In total, 52 trading sessions were conducted in Euronotes,

AUCTION DEMAND FOR MEKKAM AND NOTES IN 1998



and the volume of trading in 1998 in nominal terms amounted to USD 18.3 mln or KZT 1,376.8 mln discounted.

It is noteworthy that the price dynamics of the Exchange and over-the-counter transactions correlated completely with the quotations established in the world market. Moreover, the emergence of a steady demand for Euronotes of Kazakhstan from a domestic investor (APF) led to a rapid growth of quotations of sovereign bonds published by ISMA.

The operation on bringing sovereign Eurobonds to the domestic market was so successful that a bit later this scheme was used for the NGS market. On the first day of February 1999, Eurobonds of Kazkommerts International B.V.²⁴ were listed on KASE and became the first corporate bonds on the official list of securities of the Exchange.

As for the general situation in the NGS market of Kazakhstan, two very important laws were adopted in 1998 that had a direct impact on its development – On Limited Liability Partnerships and Additional Liability Partnerships²⁵ and On Joint-Stock Companies²⁶. This made it possible to “untangle” the pressing problem of a nearly double gap between the total number of registered JSCs and the number of JSCs that registered issues of their shares, which indicated either a large number of “dead” non-operating legal entities or the presence of joint-stock companies that failed to fulfill their obligations established for issuers. The standards of the new legislation allowed NSC to recognize 2,264 issues of shares with a total nominal value of more than KZT 86 bn as invalid only in 1998.

The Exchange under the conditions of freezing the blue-chip program started paying more and more attention to attracting second-tier enterprises. The requirements for B category were significantly softened, the pre-listing was canceled, and the Non-Listing Securities sector was divided into two levels of access.

The Exchange improved trading procedures. So, on February 10, 1998, when the first trading in domestic GS of Kazakhstan took place, the rules for trading changed. In April, according to the decision of the KASE Management Board and pursuant to the decision of the Exchange Council, new rules for trading in GS were established: the first exchange session took place from 11:30 to 13:00 Almaty time; the second exchange session – from 14:00 to 15:30 Almaty time; the third exchange session – from 15:45 to 18:00 Almaty time. The rules for NGS settlements were amended. Also in April, the Exchange Council approved the model KASE Membership Agreement. On June 18, they started transmitting the progress and results of trading in NGS and GS to the REUTERS terminals online. It was an important integration step in the international information community of financial markets.

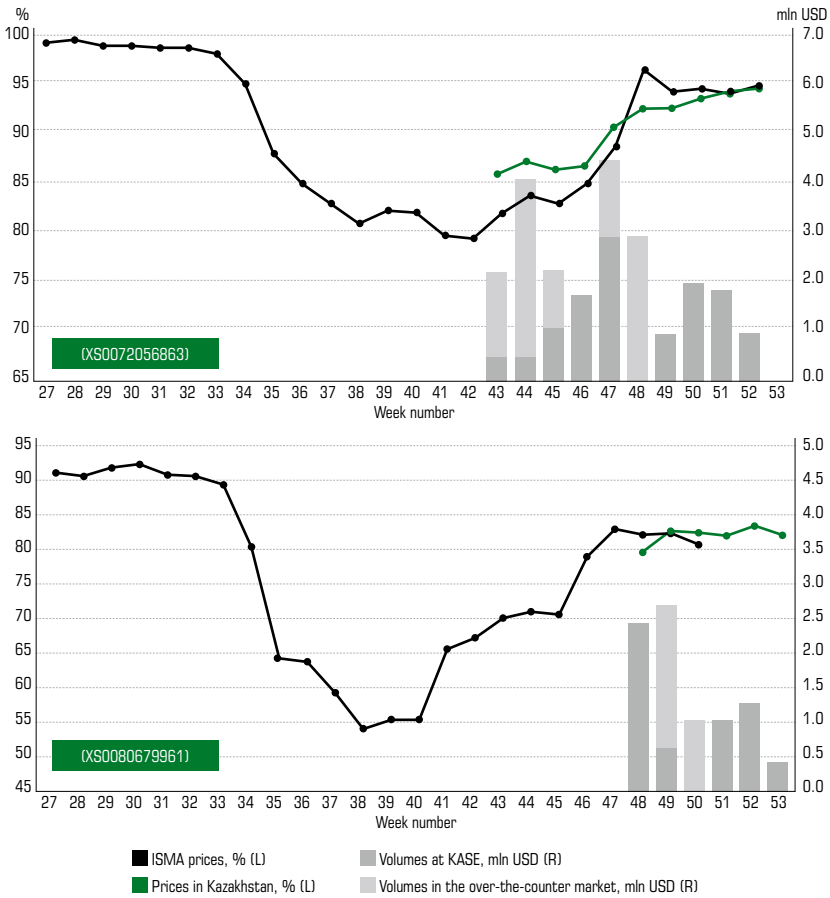
In July, the KASE General Meeting adopted a set of documents, which could significantly change the image of the NGS market. It was not only about new listing requirements or rules for trading and admission to trading. The Meeting approved a number of innovations, taking into account the updated national legislative framework (*Law On Joint-Stock Companies*).

The changes affected the liberalization of the KASE listing requirements and the requirements for professional market actors, enhancing the role of the Exchange and SM BDA as self-regulating organizations, etc.

In addition, they adopted the Code of Business Ethics of the Kazakhstan Stock Exchange Members and changed the fundamentals of operation of the KASE Arbitration Commission significantly.

At the same time, the Exchange's experts developed a quotation trading system (QTS), a special program block that would allow brokers to operate at the Exchange in indicative quotations, i.e. in the way they used to work in the over-the-counter market: with a specific counterparty at a negotiated price bypassing the automated mechanism of filling requests. In this case, each participant could place

PRICES AND CIRCULATION OF EUROBONDS IN THE DOMESTIC MARKET AND DYNAMICS OF ISMA QUOTATIONS IN 1998



their authorized requests in the system, see all the requests of other participants and choose a partner in the transaction at their own discretion. The first regular trading in QTS, whose launch essentially solved the problem of creating an over-the-counter quotation system in Kazakhstan, opened on July 15, 1998. It did not take long for the new level of the exchange service to bear fruits. The number of shares brought by KASE to trades at the initiative of brokers in 1998 increased more than nine times, and the number of financial instruments brought to the Exchange's markets by the issuers increased one and a half times. At the same time, the capitalization of the exchange market increased from USD 1,340.9 mln to 1,834.9 mln in equivalent, and the total turnover of transactions at KASE increased 11.3 times.

FLOATING EXCHANGE RATE AND SECURITIES MARKET

The introduction of the KZT/USD floating exchange rate (FER) on April 5, 1999 was equally shocking for the stock market, not only for the currency market. For example, it led to the stagnation of the secondary GS market of Kazakhstan in April and May 1999. And only in June the volume of transactions began recovering gradually as a result of the actions taken on the governmental level.

The urgent need for a series of crisis measures forced the Government to take a different look at this sector. From the continuous increase in domestic and foreign debt issued in the form of GS, the Ministry of Finance moved mainly to the debt restructuring. In particular, instead of MEKAM and notes, the Ministry of Finance and the National Bank offered new financial instruments to the market: GS indexed by devaluation with nominal value expressed in USD serviced in KZT at the official exchange rate to USD (MEKAVM and foreign currency notes of the National Bank). Moreover, on April 9, in order to protect APF assets from devaluation that occurred in the course of switching to FER, the Government issued AVMEKAM, special foreign currency government bonds of the Republic of Kazakhstan. AVMEKAM were issued through the exchange of MEKAM denominated in KZT, acquired by APFs from pension assets and being in their portfolio as of April 3, 1999. The exchange was performed by early redemption of MEKAM by the Ministry of Finance and using the revenue received in KZT to pay for AVMEKAM at the present value of convertible GS. Payment for the purchase of AVMEKAM was made in the national currency at the rate of 88.3 KZT per one US dollar. As a result, a significant part of the assets of beneficiaries of the pension system of Kazakhstan was indexed by the change in KZT/USD exchange rate, which occurred due to FER introduction. In addition, AVMEKAM later became the first GS for which a market maker appeared on KASE.

However, it was the events in the currency market that promoted the launch of domestic issues of government bonds, indexed to the change in the KZT to USD exchange rate. This gave an impulse to the development of a whole sector of

securities denominated in foreign currency, laid the foundation for the issuance of mid-term bonds of local executive authorities indexed to the exchange rate change.

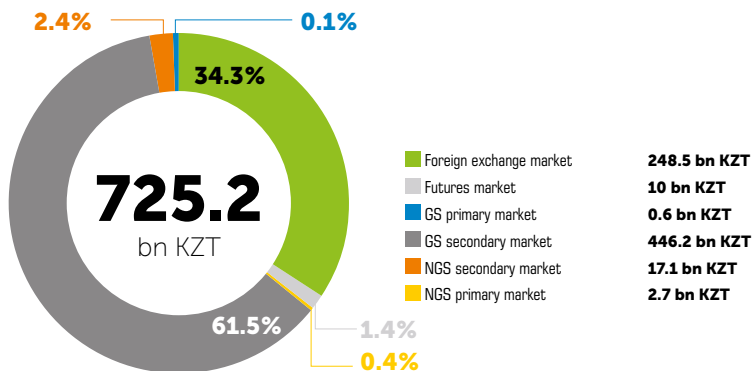
The Exchange kept on working on expanding the exchange segment of the market. The main goal was to create maximally convenient conditions for GS traders, including both trading and settlement services. Meanwhile, the regulatory framework was improved. The expanded exchange services for the provision of remote access to trading, continuous modification of the trading system, the system for prompt settlements and confirmation of transactions resulted in the largest market operators brought to the market in 1999.

At that time, together with NSC, the long-standing problem of the secondary GS market of Kazakhstan was resolved – the repo transactions sector opened at KASE on July 5, 1999, and direct transactions (without using the continuous counter auction) were prohibited in the GS sale and purchase sector on August 2, 1999. Due to this event, starting from August 2, the Kazakh market received two very important objective market indicators: the true value of "short" money and the true market yield to maturity of GS in the secondary market.

A reliable calculation of these indicators was practically inaccessible to an ordinary investor before, since the vast majority of GS prices included repo rates that were known only to parties to the transaction. Only dealers, who were constantly working in the market, could have an idea about those indicators (however, far from accurate ones). With the information activities of KASE and the IRBIS Information Agency of the Financial Markets established by the Exchange, the maximum information transparency of the secondary GS market of Kazakhstan was achieved in 1999.

During 1999 KASE never charged a fee on participants for GS trading in the market. Trading in AVMEKAM was the only exception, where the fee was introduced solely to incentivize the market maker of these bonds. KASE consistently developed

VOLUME AND STRUCTURE OF THE EXCHANGE MARKET IN KAZAKHSTAN IN 2000



the sector of domestic GS, turning it into an informationally transparent and liquid market accessible to an ordinary (including mass) investor.

This work was continued in 2000 – the year was much calmer for the GS market. For the first time, the GS repayment volume exceeded GS placement volume, while the yield on short-term securities reduced more than twice. This happened due to the fact that the state budget of the country had a relatively low need for borrowings. The general situation also contributed to this – a significant decrease in the KZT to USD devaluation rate (from 64.2% to 5.2%) allowed abandoning the issue of MEKAVM indexed to devaluation in the second quarter. The Ministry of Finance reduced borrowing volumes and increased the period for GTB placement.

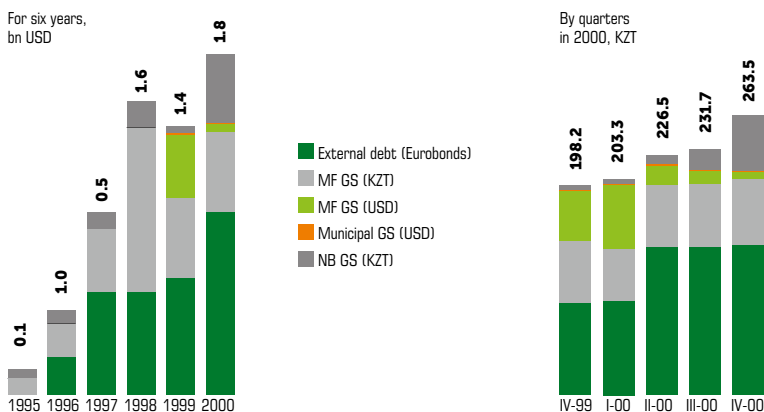
The trend for an increase in medium-term securities started in 1997. Previously, only “short” securities were issued with a maturity of three, six and twelve months.

In general, the amount of government debt of Kazakhstan issued as GS in the domestic and foreign markets increased from USD 1.434 bn to 1.818 bn in nominal terms over the year. At the beginning of the year, the nominal value of GS of the Ministry of Finance and municipal authorities amounted to KZT 105.5 bn, while at the end of the year this figure dropped to 68.9 bn.

In May 2000, all of the mid-term indexed to devaluation AVMEKAM in circulation were converted into fourth-issue Euronotes of the sovereign debt of Kazakhstan. As a result, the share of domestic GS tied to the change in the value of the dollar, decreased from 44.5 to 9.1% of the total internal debt of the Ministry of Finance over the year.

The secondary GS market fully recovered. Its volume increased 2.64 times in 2000 – up to KZT 625.4 bn. The expansion of the market was mainly influenced by two factors. High liquidity in the financial sector, which was in particular evidenced in the last quarter of 2000, was the main factor. The growth of market capitalization also played a certain role.

THE AMOUNT AND STRUCTURE OF THE DEBT OF KAZAKHSTAN ISSUED AS GS (AT THE END OF THE PERIOD)



Another event occurred in this market segment. In May, the KASE Exchange Council decided to arrange the Small Lot Sector, which opened on July 3. Sixty transactions with Euronotes of Kazakhstan for the amount of USD 7.4 mln of the nominal value of the debt were conducted there over the year. The volume of transactions amounted to KZT 1.2 bn – 0.27% of the total GS turnover at KASE and 0.73% of the total turnover in the GS sale and purchase sector at KASE. Unfortunately, a retail investor did not come to the sector due to the low yield on Euronotes and quite high transaction costs when working in the sector. Nevertheless, the GS market at KASE has been established both in terms of the developed regulatory framework, created infrastructure and the settlements system, and in terms of the composition of participants.

ON THE EVE OF A BOND BOOM

But the market was ready not only for GS, but for securities of the corporate sector. First of all, for more reliable bonds.

According to Galina Tsalyuk, Managing Director, Director of the Listing Department of KASE, "In 1999, the first signs – the forerunners of the "bond boom" that happened soon – Euronotes of Kazkommertsbank appeared on the official list. The needs of the new institutional investors of Kazakhstan – accumulative pension funds – in investing pension savings kept on growing at a very fast pace. This was the main reason for the "bond boom". First, municipal bonds were actively placed on the Exchange, and then corporate bonds followed. They were excitingly active. The demand for securities almost always exceeded supply."²⁷

In 2000, the securities market of Kazakhstan developed so much that it became noticeable as a component of the economy, which, first, allowed solving the problem of non-inflationary coverage of the state budget, and second, the issue of nonbank financing of the real sector. The list of instruments expanded. Transactions were made in foreign currencies, GS, non-government serial securities and forward exchange contracts; municipal securities and non-government corporate bonds were placed. The total turnover of all sectors of the regulated financial market increased 1.64 times to 27.9% of GDP compared with 1999 (21.9% in 1999), and the regulated component of the financial market had never controlled such a high turnover of money in the republic before. Exchange traders associated these indicators primarily with the success of Kazakhstan in economic development.

Sustainable growth was typical for most sectors of the market. The largest increase – 7.1 times – was recorded in the NGS sector, which reflected the dynamic development of the corporate bond market. PAMCs demonstrated their interest. The continuous growth of assets of the pension funds of Kazakhstan and the

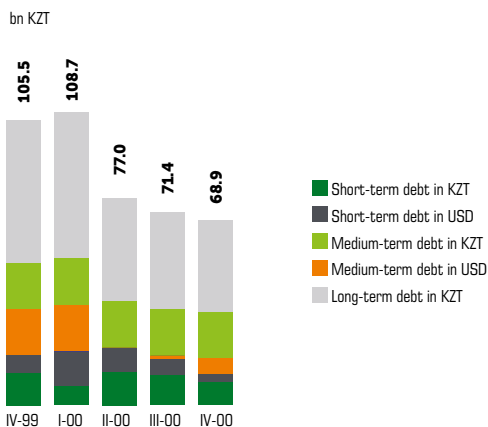
resource base of STB demanded an increase in the volume of investment in the real sector of the economy, and this opportunity was partially used.

According to **Damir Karassayev**, President of Kazakhstan Stock Exchange CJSC from April 1999 to April 2002, "The need to list corporate bonds on the Exchange appeared only with the arrival of pension funds. One of the first issues of bonds that I remember best of all was that of Almaty Kus. Kazkommerts Securities JSC did much work to prepare the issue – they made up a good company memorandum. It was a good demand for Almaty Kus securities; the bonds generally proved to be a worthy alternative to a bank deposit. The volumes were tiny then. I don't remember exactly, but, in my opinion, the volume of issue amounted to USD 15 mln. Those issues were significantly different from the current volumes. The bonds were denominated in dollars, but all settlements were made in tenge at the Exchange rate.

A professional team of people worked at the Exchange, which showed that if they did right, the segment where they aimed their efforts at, developed, of course, if market conditions allowed this. Now we can surely say that after the establishment of pension funds, the Exchange had the historical opportunity to show that it could develop its segment of the securities market."²⁸

The most important trend of the year 2000 was the increased interest in corporate bonds, which led to the phenomenon that was later called in CIS countries as the Kazakhstan bond boom. For the first time in the history of the republic, banks and enterprises, solely at their own initiative, sought to get their bonds officially listed on KASE's A category, thereby gaining access to the assets of pension funds.

THE AMOUNT AND STRUCTURE OF INTERNAL DEBT OF THE MINISTRY OF FINANCE AND MUNICIPAL AUTHORITIES IN 2000 (AT THE END OF THE PERIOD)



Komirbank OJSC²⁹ was the pioneer. As part of the auction held on the Exchange on February 18 by the open outcry, its annual registered coupon bonds indexed for the change in KZT/USD exchange rate were placed at the rate of 12.26% per annum.

The securities of KAZAKHOIL NOC CJSC³⁰ issued for a very large amount for that time – USD 25 mln were highly demanded. They were placed on KASE on June 23, 2000 and it was the third event after Komirbank OJSC and Almaty Kus OJSC. It should be noted that KAZAKHOIL, as some people believe, did not urgently need such kind of borrowing. The issue was arranged mainly in order to support the country's stock market and provide APFs with a quality investment facility.

High demand for corporate bonds had a positive effect on their yield and forced banks to lower lending rates under the pressure of competition from the bond market. All this made investor money more affordable not only to large companies, but also to medium-sized enterprises. Some of them managed to successfully place their bonds on the stock market and receive relatively cheap money for the development of production.

Thus, the year 2000 can rightfully be called the year of bond issues in the NGS sector at KASE, since the above-mentioned sector expansion was mainly due to the rapid development of the corporate bond market.

At the end of the year, the total capitalization of the exchange bond market was estimated at USD 176.8 mln in nominal terms. The 5.8 times growth was observed for the year that gave a reason to talk about the bond boom of Kazakhstan. There was nothing like that nowhere in CIS countries, including Russia. Kazakhstan held leadership in the market until the crisis of 2009. The motivation of companies to be officially listed on KASE's A category was easy to understand – it opened the door to APF investment resources. Therefore, the expansion of the market went in that very direction. At that time APFs existed only in Kazakhstan.

Due to the appearance of corporate bonds on the Exchange, KASE's trading list was divided into a sector of shares and a sector of bonds. A total of 81 securities from 54 issuers were listed on the trading lists of the Exchange at the end of the year, including 39 on the official list and 42 on the Non-Listing Securities list.

At the end of the year, the total capitalization of companies, whose shares were listed on KASE, was estimated at USD 1,342.3 mln or KZT 195.2 bn.

However, for pension funds, which began to increase their assets rapidly, these volumes were insufficient.

Dmitriy Zherebyatyev, Regional Manager of Finastra, who worked for Zhetysu PAMC, recalls: "We mainly looked at bonds. It was the best instrument for pension funds as conservative investors. At that time, the portfolio of Ular Fund had up to 99% of bonds. Then there was an understanding that by launching the accumulative pension system, the state still had to think through a system of instruments to invest pension assets. Initially, we bet on blue chips, in which it was decided to invest pension assets. However, we planned to limit the bank deposits, even with introduction of a tax.

This did not happen – no developed investment system appeared and the pension money began to flow gradually into the banking sector."

BRAND EVOLUTION

In the first six years of its operation, KASE had to go through a whole series of renames, re-registrations and reorganizations, and even exist in two legal forms for almost two years. Moreover, the lion's share of these "zigzags" was directly related to the emergence and development of the stock market as such and its regulatory and legal framework. Chronologically, the evolution of the name of the Exchange was as follows:

- December 30, 1993 – a closed joint-stock company Kazakh Interbank Currency Exchange was registered.
- March 3, 1994 – the Exchange was reregistered as the Kazakhstan Interbank Currency Exchange.
- July 12, 1995 – new name was registered – Kazakhstan Interbank Currency Stock Exchange. The "stock" element in the name of the Exchange showed the decision of the General Meeting of Shareholders to distribute its activities to the securities market.
- April 12, 1996 – the Almaty Justice Department officially reregistered the Exchange due to the change in its name to Kazakhstan Stock Exchange (KSE) CJSC; the Exchange's subsidiary Kazakhstan Currency Exchange LLP was registered on the same day – they planned to move trading in foreign currency there. Such reorganization was caused by NCS recommendation to bring the name and activities of the Exchange in compliance with the requirements of the Decree of the President of Kazakhstan *On Securities and Stock Exchange* dated April 21, 1995, which prohibited the stock exchanges to act as a commodity exchange.
- June 13, 1996 – the Exchange Directorate decided to liquidate Kazakhstan Currency Exchange LLP, since the Exchange Council included in the agenda the issue of separation of a joint-stock company from KSE under a conditional name Kazakhstan Currency Exchange.
- Since the new Law of Kazakhstan *On Securities Market* dated March 5, 1997 did not allow a stock exchange to act as "other exchanges", on April 12, 1997, the General Meeting of Shareholders decided to complete KSE reorganization by separation of Almaty Financial Instruments Exchange CJSC (AFINEX).
- July 3, 1997 – due to transformation of a portion of KSE's shares into AFINEX's shares, Kazakhstan Stock Exchange CJSC (KASE³¹) was reregistered again by the Ministry of Justice of Kazakhstan; Almaty Financial Instruments Exchange CJSC, a specialized organizer of trading in foreign currencies and term contracts for foreign currencies, got its state registration certificate on July 30, 1997. Such separation had just a legal and artificial nature. Actually, the personnel of both exchanges was still the same team and used the same trading system, facilities and technologies.
- July 10, 1998 – mainly through the efforts of exchange traders, the Law *On Securities Market* was clarified – the prohibition for stock exchange to act as "other exchanges" was narrowed to "commodity exchanges". Since currencies were not on the official list of exchange commodities, KASE and AFINEX qualified for reunification.
- By April 1, 1999, all legal procedures for a merger of the exchange markets were completed and the name Kazakhstan Stock Exchange and well-known abbreviation KASE have remained unchanged so far.

This was a problem of not regulation or the Exchange, but of the whole transformed economy, which was moving from a centrally planned model to a market one and could not keep up with the needs of the new market institutions.

During that period the Exchange was actively working to improve the internal documentation and procedures. Thus, on July 1, 2000, a new edition of the KASE internal document came into effect that regulated the settlements following trading in securities. For the first time ever at KASE, it contained a legal framework developed, which allowed making settlements following NGS trading using netting.

The key results of the year included the completion of the establishment of the primary NGS market and the secondary corporate bond market, as well as the establishment of the repo transaction sector. There was no official opening of the repo sector for NGS on KASE, as such. The sector actually started operating as initiated by brokers in March 2000, no one could, however, speak about its maturity even at the end of 2000. The range of instruments used was very narrow, the repo terms varied greatly, and the rates did not often match the real market level. The first "official" repo transaction on NGS was conducted on the Exchange on March 14; 40 repo transactions for the amount of 3,168.7 mln KZT were made over the year.

In 2000, the Exchange could overcome one of the negative trends of 1999 in the NGS market – a large number of contractual transactions without market pricing. Such transactions were called direct transactions. However, they could do without administrative measures – the share of market transactions made in the KASE trading system by the counter auction grew steadily and exceeded 90% at the end of the year.

* * *

So, the first stage of the establishment of the stock market of Kazakhstan was left behind. It was a time of trial-and-error search, first victories and failures, cooperative efforts of the private and public sectors. Started from scratch, the market gradually got the basic elements necessary for its further development, such as basic legislation and an independent regulator, first issuers and institutional investors, professional participants and a uniform universal exchange market. Seeds were sown and grown.

Following the results of 2000, KASE made an impressive progress. The total turnover of all sectors of the organized financial market amounted to 27.9% of the country's GDP. Growth in the volume of transactions at KASE was observed in most sectors of the market. The largest increase – by 613.1% or 7.1 times – was recorded in the NGS sector. And this growth, first of all, ensured the dynamic pace of development of the corporate bond market. The increase in the volume of repo transactions, which amounted to 16% of the total volume of NGS transactions and 18.6% of the volume of the secondary NGS market at KASE, played a role in expanding the exchange turnover of NGS.

It was high time for an abundant harvest of the noughties...



Annual General Meeting of KICSE Shareholders, 1995



*The workshop of professional players
of Kazakhstan's securities market, 1997*



K  **SE**



Chapter 3

PATTERN OF GROWTH

GS MARKET: TIME AND BURDEN OF "OVERHEATING"

**THE CORPORATE BOND MARKET: ON THE WAVE OF THE
"BOND BOOM"**

**STATE-OWNED STAKE TRADE SECTOR:
NOT ONLY FOR "STRATEGISTS"**

STOCK MARKET: FROM SKEPTICISM TO EUPHORIA

REPO TRANSACTION MARKET: MOVES AND WINS

**FOREIGN EXCHANGE MARKET: THE MOMENT OF GLORY
FOR TENGE**

Chapter 3.

PATTERN OF GROWTH

The first year of the new century marked the explicit entry of the economy of Kazakhstan into a phase of strong growth, which lasted until 2007. The average annual growth rate of GDP for the period reached 10%, and therefore many experts call this period nothing less than “fat years”.

The investment climate of the country was highly favorable. Foreign investment flew like a river¹. However, these flows went, as a rule, into the share capital of Kazakh enterprises with foreign participation. If we talk about the debt capital market, there was a clear bias towards short-term lending, while the real economy needed long-term financing. This imbalance between supply and demand dictated to update priorities to the market. The National Bank, headed at that time by Grigoriy Marchenko, focused on finding long money. In the domestic market, long money sourced from the growing assets of APFs. Kazakh APFs had significant influence on the cost of foreign borrowing, acting as the ultimate investors of debt securities of Kazakhstan issued in accordance with foreign laws.

Banks increasingly started getting loans abroad, since borrowing costs in international capital markets began to fall. They started granting cheap and long-term money willingly to Kazakh issuers of Eurobonds amid rising oil prices. At the same time, the revenue of the oil sector grew.

Meanwhile, domestic economy could not absorb the increased cash flow. As a result, the first symptoms of overheating became more and more apparent. This was most clearly manifested in the fall in government securities rates to levels that were not adequate to the economy development level or economy risks, or the inflation rate. This problem became evident already in 2002, and the republic faced it closely in 2003.

The issue of money sterilization technology was not new for the monetary authorities of Kazakhstan. The volume of money was, perhaps, new. Of the several methods of struggling against overheating of the economy, two were the most accessible at that moment, they were the removal of excess profit from the export of raw materials to the “savings box” of the National Fund, which was established in Kazakhstan following the Norwegian example in May 2001, and also high issuing activity of the government institutions, first of all, the National Bank. The diversification of the economy as a method of dealing with the economy overheating required more time and the availability of a business that could develop new sectors, and many other things that could not appear all of a sudden and operate efficiently.

Under the conditions described, the need to finance the state budget deficit of Kazakhstan decreased sharply, and in 2005 and 2006 we could observe the surplus budget. Therefore, the policy of the Ministry of Finance in the market has changed –

it always tried to wind up the issue of new GS. However, the risk of losing the market and investors in the future and the presence of constantly growing pension assets requiring decent investment facilities made the Ministry of Finance focus on making its debt longer and, in particular, cheaper. The National Bank, which remained virtually alone face-to-face the growing money supply, had to increase its issuing activity dramatically, since its main task was to control the inflation rate in the country. Notes allowed removing the excess liquidity from the market so that it would not put pressure on the inflation rate.

Thus, with seemingly increasing well-being, when "money flows like a river", risks and imbalances began to increase in the economy of Kazakhstan...

GS MARKET: TIME AND BURDEN OF "OVERHEATING"

The dynamics of public debt issued in the form of GS in 2001–2006 demonstrated its growth – almost five times from USD 1.6 to 7.6 billion with subsequent decrease to 6.3 billion in pre-crisis 2007. Under the influence of the economic situation, its structure, the main parameters and the priorities of GS issue changed dramatically over the seven "fat" years. The role of KASE in the market that eventually managed to bring primary placement of bonds of the Ministry of Finance to its market changed as well.

Key investment instrument...

By the beginning of 2001, the Ministry of Finance experienced much less need in borrowings to finance the budget. The environment of world commodity markets favorable for Kazakhstan ensured the necessary revenues to the treasury.

Under the conditions of growing tenge liquidity, the number of institutional investors, and, accordingly, the size of their assets grew, and the deficit of investment facilities remained the same.

This allowed the Ministry of Finance to restructure its debt to extend it, gradually increasing the volume of medium-term bonds issued and bringing new instruments to the market. By using the increased demand for its securities, MF could quickly reduce the cost of servicing of the issued debt and fix the coupon interest rates.

As a result, the primary market of MEKAM and notes of the National Bank turned into a kind of a "deposit store", where market professionals addressed to place money at a previously known rate of return. APFs competed with each other on securities placement thereby making effective yield of such securities negative.

Stabilization in the public finance could also be indicated by the fact that the first MAOKO government securities appeared in the primary market; they were special compensatory treasury bonds issued by the Ministry of Finance on

December 29, 2002 in the amount of KZT 12.5 billion. They were a means of compensating for the population's deposits held in the accounts of the former USSR Kazakh Republican Savings Bank. The Ministry of Finance transferred these bonds to its financial agent, Halyk Bank², which started reissuing balances of deposits in bonds from March 1, 2003. Thus, the government confirmed its intention to take care of the welfare of residents and compensate for depreciation of deposits in rubles.

The growth and change in the structure of the primary GS market was mainly due to an increase in the volume of notes issued by NBRK and mid-term MEKAM of the Ministry of Finance. The volume of sovereign debt in the form of Eurobonds stopped growing – the Government adhered to the intended strategy of foreign borrowing rejection, using the opportunities of the domestic market, where it was possible to borrow cheaper and for a longer period, increasing MEOKAM issuance. This led to a steady decline in the yield of Eurobonds for buyers on the secondary market. These securities were redeemed by Kazakh APFs immediately after being allocated in the foreign market. As a result, the secondary market of these GS operated in conditions of constant "overheating", and the spread between the yields of Euronotes of Kazakhstan and US GS was rapidly narrowing and in some moments, paradoxically, even became negative. Moreover, in 2003, the strengthening of the tenge against the US dollar led to a drastic contraction of the secondary market of sovereign Eurobonds of Kazakhstan, so it simply became unprofitable to sell these securities at current prices.

The loss of this once-profitable instrument as well as the early redemption of MEAKAM by the Ministry of Finance in 2003 only increased the investment "hunger" of pension asset managers.

On September 25, 2003, new Rules for Pension Assets Investment Management were adopted in Kazakhstan as approved by Resolution of the Management Board of the National Bank of the Republic of Kazakhstan No. 264 of July 29, 2003. From that time onwards, all asset managers, including UAPF, could independently place pension assets under their management; however, the portfolio should have been well-diversified and included the most reliable non-government securities.

On the one hand, this provided a potential opportunity to reduce the demand for GS of the Ministry of Finance and the National Bank from the largest Kazakh pension fund UAPF, but in fact the innovation had a minimum impact on the market. On the other hand, this Resolution instructed PAIMO to sell non-government bonds in their investment portfolios issued by foreign issuers (so-called SPV ("Special Purpose Vehicles"³), whose shareholders were only organizations of the Republic of Kazakhstan. Since SPV bonds were very popular with APFs, the ban on their purchase through pension assets led to an increase in demand for domestic government securities of the Ministry of Finance and NBK in subsequent years.

For KASE, the dominance of banks in the financial market resulted in a gradual fall in the exchange share in the GS purchase and sale market. For example, if in 2001 it was 64.8%, then in 2002 it dropped down to 57.8%, and in 2003 it fell to

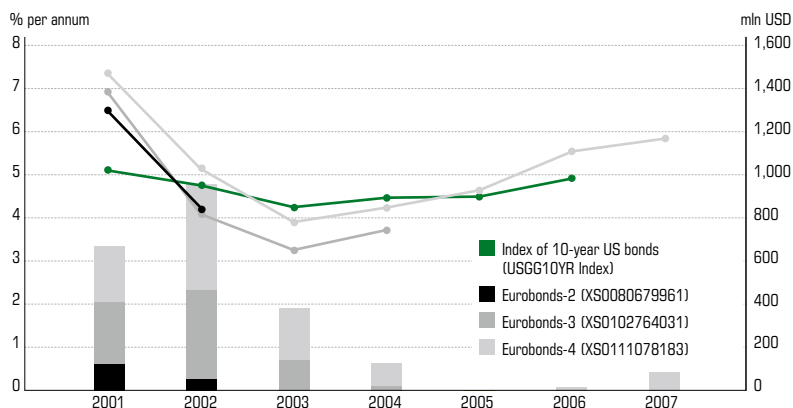
49.8%⁴. This was despite the fact that KASE did not charge commission fees on the participants of the GS bidding. This was mainly due to the increasingly active involvement of government bonds in banks' financial schemes, since transactions with government securities were not taxed. Such transactions were generally made outside the Exchange. In addition, the list of Primary Dealers of the Ministry of Finance was presented mostly by banks. They were the ones that purchased bonds in the primary market on favorable terms, and then resold them to other investors, including those outside the Exchange.

The development of the situation with the excessive tenge liquidity still remained a general concern and the Ministry of Finance had to focus on the issues, whose solution, strictly speaking, was not part of the direct responsibilities of the government authority. Without difficulties with financing the budget revenues, it had to help the National Bank in sterilizing the market from "extra" money, and investors in solving the problems of lack of financial instruments.

In February 2004, the Minister of Finance Yerbolat Dossayev⁵ started speaking about the need to actively develop the domestic GS market to help NBRK keep the tenge from excessive strengthening and provide APFs of Kazakhstan with long-term tenge instruments. This task was called "a priority", and it was supposed to be solved by the Ministry of Finance's rejection to borrow from abroad and bringing long-term (15–20-year) savings bonds indexed by inflation rate to the domestic market of Kazakhstan specifically for the needs of APFs. The Ministry of Finance announced its intention to abandon the institution of the Primary Dealers in SG market, through which bonds were placed, and to make placement at KASE.

Throughout the year 2004, the Ministry of Finance, the National Bank and KASE made extensive preparatory work, which resulted in new Rules for the Issue,

EUROBONDS OF KAZAKHSTAN: WEIGHTED AVERAGE YIELD AND VOLUME OF SALE-AND-PURCHASE TRANSACTIONS AT KASE IN 2001–2007



Placement, Maintenance and Redemption of Government Treasury Bonds of the Republic of Kazakhstan approved by Resolution of the Government of the Republic of Kazakhstan No. 941 of September 8 and enacted on January 1, 2005 as well as a package of internal documents of the Exchange governing the placement of the Ministry of Finance's bonds at KASE. In the course of preparation, the government implemented liquidity withdrawal through another mechanism – the development of a mortgage lending program. In accordance with the program, the Kazakhstan Mortgage Company made five new issues of secured bonds with a total par value of KZT 25 billion.

From technological and organizational point of view, KASE was ready to transfer the primary GS trades to its platform – the Exchange modified the trading system and developed the settlement procedures based on the results of the MEKAM placement. Moreover, the Exchange itself was the initiator of the innovations. *Azamat Dzholdasbekov*, who headed the Kazakhstan Stock Exchange in April 2002, recalled his second arrival at KASE and said that he almost immediately began to seek to place bonds of the Ministry of Finance at the Exchange, as this would significantly increase the number of participants through financial institutions willing to buy bonds without intermediaries, and would have a positive effect on the exchange trading volumes. In addition, it was possible to use progressive exchange technologies both in the collection of requests and in settlements.

"I went to the Ministry of Finance and said that we would like to launch the platform to place the government securities currently being sold through the National Bank, that we offered market-based, transparent, very well-worked ways of selling securities through the Exchange. It worked out – the Ministry of Finance agreed. Where there is a primary trade, it's only right to start a secondary trade. In addition to this secondary trade, we added repo transactions later. To be more accurate, these transactions were launched even earlier, the mechanism was created. But one thing is to trade in corporate securities available today, but not tomorrow, and a different thing is to trade in government bonds. Since then, the repo sector with GS has been the most active on the Exchange."⁶

The fateful moment occurred on January 27, 2005, when the Ministry of Finance held the first offering of MEUZKAM intended for APFs on KASE.

In general, in 2001–2006, an increase in the sovereign debt of Kazakhstan issued in the form of government securities was often caused not by the needs of the republican budget, but by the need to bind the excessive tenge liquidity in the market and support domestic institutional investors. The government securities of the Ministry of Finance became basically "instruments of forced investment" for a significant amount of assets inside the country, and to a large extent this concerned assets of pension funds, which had no place to invest in such volumes – the corporate sector did not provide the necessary level of investment quality of instruments. As a result, even despite the steady budget surplus in 2006, the total

amount of debt issued by the Ministry of Finance increased from USD 1.47 billion in 2001 to USD 3.3 billion in 2006 or 2.3 times.

By the end of 2007, the need to finance budget deficit was back on the agenda and it forced the Ministry of Finance to make its securities more attractive for investors. The rates on mid-term and long-term MEKAM on the primary market were up 300–400 b.p. due to the credit crisis and the escalated inflation rates.

...and a Waiting Instrument

The dynamics of the volume of short-term notes of the National Bank looked much more dramatic. The National Bank while struggling with the excessive tenge liquidity was forced to increase its debt by more than 35 times – from USD 0.12 billion to USD 4.21 billion in 2006.

The increase in sales of currency earnings of exporters in the domestic market led to the need for the National Bank to buy up the national currency in order to maintain a balanced real exchange rate of the tenge to the currencies of the countries, which were major trading partners of Kazakhstan, as well as to the US dollar. The real sector of the economy simply could not digest quickly enough the tenge released for circulation in this way. In that situation, in order to reduce inflation risks and provide domestic institutional investors with the facilities to invest free money, the National Bank had to boost its issuing activity. The volume of issue of notes grew in an arithmetic progression. In some years, there was a unique situation when half of the sovereign debt issued in the form of government securities was the outstanding notes of the National Bank of Kazakhstan. The actions of the National Bank were also explained by the fact that the Ministry of Finance did not regularly issue new bonds into circulation, and therefore it had to deal with sterilization of the market from the free tenge more often and for shorter periods.

On February 21, 2002, the Rules for Placement, Circulation and Redemption of Short-Term Notes of the National Bank of the Republic of Kazakhstan⁷ were enacted in a new edition, significantly revised compared to the previous ones. Due to this fact, the issuer expanded its capabilities in the primary market and, in particular, legalized the early redemption of notes. The new rules, mainly taking into account the five-year experience of placing notes, provided the National Bank with an opportunity to respond faster to changes in monetary aggregates, but did not fundamentally change the order prevailing in the market.

On May 31, 2003, amendments to the Rules for Issue, Placement, Circulation and Redemption of Short-Term Notes of the National Bank of the Republic of Kazakhstan approved by Resolution of the Management Board of NBK No. 109 dated April 10, 2003 became effective, according to which the limit for the maximum circulation period of notes of 91 days was cancelled. As a result, the National Bank could manage its debt in a more efficient manner, promptly responding to changing market conditions, and also significantly increased borrowing by issuing longer-term securities.

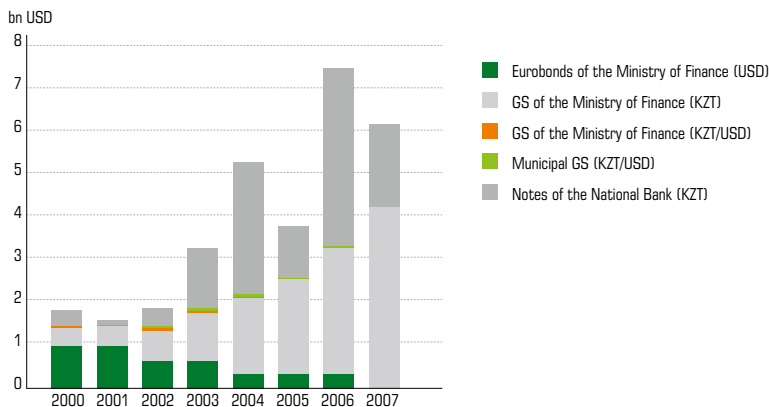
It should be noted that the trend to extending the weighted average period of notes sold at auctions was observed during the entire period of "fat years": from 65 days in 2001 this period was extended to 78 days in 2002, to 155 days in 2003 and reached 244 days in 2004. The level of demand for the National Bank's securities was characterized, for example, by the fact that back in 2003, the issuer had already attracted more than KZT 20 billion with separate placements of its notes, and the average volume of one issue of notes placed in the same year exceeded KZT 5,014 million. This was despite the fact that the real yield of securities sold at auctions was below current inflation rates.

The change in the structure of the National Bank's outstanding debt also affected the secondary exchange market. Investors increasingly invested in these securities as the shortest "waiting instrument". The resale of such notes purchased at auctions by banks to the pension market actors within one to three days after the placement was the most popular transaction. In that case, the price difference was insignificant and almost did not change the yield of called bonds for the buyer, but the yield for the seller was very high.

However, as in the case of MF's GS, the "seller's" market allowed the National Bank to dictate the conditions of the game and constantly reduce the yield of its notes. This was especially clearly manifested when servicing such a large-scale debt for the first time in several years resulted in losses for NBK in 2004. In this regard, the central bank actively benefited from the demand to reduce the cost of service, while disregarding the indicative money market rates set by the central bank. If in 2001 the weighted average effective yield on short-term notes was 8% per annum, then in 2005 it dropped to 2.31%.

It should be noted that in the same 2005, with the continuing rise in oil prices, a stable and sometimes declining USD/KZT exchange rate, as well as

THE DYNAMICS OF THE DEBT OF KAZAKHSTAN ISSUED AS GS AT THE END OF THE PERIOD IN NOMINAL TERMS OF DEBT



improved well-being of residents, an increase in the volume of foreign currency lending to individuals became obvious. This growth significantly exceeded the increase in currency liquidity among the population and the dynamics of foreign currency deposits. With a free access to cheap money from abroad, banks increased lending in foreign currency, most likely realizing that the population's foreign exchange earnings did not cover their future loan payments. Currency risk was underestimated, and the government decided to force banks to take this risk into account.

Speaking at the lower PHouse on May 30, 2005, Arman Dunayev⁸, Finance Minister, said that measures would be taken soon to increase reserve requirements for second-tier banks in order to limit external borrowing. The fact that the new rules would come into force on October 1 at a constant reserve ratio (6% of current liabilities) became known on June 16. At the same time, FSA head, Bolat Zhamishev⁹, explained the essence of the innovations, according to which the base for calculating the reserve requirements of banks would be expanded to include external obligations. In addition, previously provided deposits with the National Bank of Kazakhstan, overnight loans provided by the National Bank, and refined gold would be excluded from the reserve assets. Furthermore, the new list of reserve assets would include cash in tenge and money on correspondent accounts with the National Bank. According to regulators, all this should have made foreign loans less attractive to Kazakh banks.

The market responded to the information received by a sharp increase in demand for the US currency in June and, partly, in July 2005, i.e. long before the adoption of the new rules (October 1). This allowed the National Bank to try to regulate the market through discount rates, real money market rates, and also through changes in reserve requirements for second-tier banks. As a result, the net borrowing balance of the National Bank in the GS market in 2005 amounted to minus KZT 250 billion.

However, in the following year this gain was nullified – the volume of the National Bank's outstanding debt increased 3.5 times to USD 4.1 billion, while there was a gradual increase in the effective yield of short-term notes and it was 4.41% per annum at the last auction in December. As long as 2007, the market and the government had to solve completely different problems. The priorities shifted towards maintaining liquidity in the financial system. This made the National Bank redeem its bonds before maturity by buying them in the secondary market. As a result, the value of the debt of the National Bank in circulation decreased from 7 billion in August to USD 2 billion in December 2007.

Municipal Bonds: The First Act

At the beginning of the 2000s, the first wave of bonds of local executive authorities of Kazakhstan, called "municipal bonds" by financial community, occurred at KASE.

It should be noted that the experience of borrowing by Akimats through the issuance of bonds was gained much earlier. As early as March 18, 1996, the placement of the first series of the issue of the first regional loan Social Support for the Population of Pavlodar Region of 1995–1997 began. The bond issue prospectus for a total amount of KZT 100 million was registered with the Ministry of Finance under No. 001. These were coupon bonds at par of KZT 1,000 with a declared yield of 35% per annum, issued in paper form and placed outside the organized exchange market.

The exchange history of debt securities of local executive authorities (LEA) started on June 29, 1999, when municipal bonds of the Mangistau Region Akimat were listed on KASE. These were the first securities sold on KASE by an auction – the so-called specialized trades, and the first municipal securities of Kazakhstan were listed on the Exchange.

By that time, the right of LEAs to issue securities for financing regional investment programs was enshrined in the Law *On the Budget System*¹⁰, and later on in the Law *On Public and Government-Guaranteed Borrowing and Debt*¹¹.

The organizational foundations of the new exchange market segment were laid in the form of two regulatory documents, they were: The Rules for Listing the Government Securities on the Exchange and The Rules for Conducting Auctions for the Initial Placement of Securities, approved on June 21, 1999 at the General Meeting of KASE Members and by NSC Resolution No. 358 of June 29. The main trigger for Akimats to enter the KASE market was NCS Resolution No.36 of June 24, 1999, which allowed PAMCs to invest in government securities issued by local executive authorities of Kazakhstan, provided that these securities were allowed to be listed on the KASE trading systems, and PAMCs were authorized by the NSC Director to purchase such securities at the expense of pension assets.

Unlike other government securities, which were listed on the Exchange automatically upon their registration, a special procedure was developed and introduced for listing of municipal securities for trading on KASE. This was explained by the fact that both the market and the regulator understood the differences in investment quality of MF and National Bank's GS of one part, and municipal bonds of the other part. Despite the status of the government securities, the bonds of local executive authorities, according to market actors, were characterized by significantly greater investment risk for both objective and subjective reasons.

When listing municipal GS on KASE, the Listing Commission focused on a detailed analysis of materials provided by Akimats in order to maximize the disclosure of information concerning the financial condition of the municipality. At the same time, using all information and dissemination infrastructure available to KASE and IRBIS Agency, the Exchange introduced the investment memorandums of the projects to the public. This approach ensured informational transparency, organization of an independent expert risk assessment and was, perhaps, the first example of such a comprehensive and open discussion of investment projects in Kazakhstan.

LISTING COMMISSION AND LISTING ON KASE

Securities undergo a listing procedure to be admitted to trading on KASE and to be included in the Exchange's official list. The availability of this procedure on the Exchange was of great importance at all times. It was particularly important at the time when the financial market was fledgling because the market was poorly regulated and the listing was a kind of rating for investors. Besides, at the stage of the listing, specialists of the Exchange interact with an issuer or its financial advisor, and if the issuer is a novice, it actually learns how to enter an organized market.

Up until the year 2007, the issues related to listing and delisting, change of categories of securities were within the competence of the Exchange Council. The documents submitted for the purposes of listing an issuer or a member of the Exchange (they are called admittance initiators) were checked by the Listing Commission, a collegiate non-structural body of KASE, which was specially created for this purposes. It also prepared an opinion on the compliance of securities and their issuer to the listing requirements and gave recommendations to the Exchange Council on each specific securities based on their compliance with the listing requirements and the risk inherent in these securities.

In 2006, the Exchange Council members suggested to transfer powers on listing, delisting and changing the category of securities from the Exchange Council to any other body of the Exchange. After studying the practices of other exchanges, it was decided to transfer these powers to the Listing Commission and to change its function at the same time. It was anticipated that it will still be a collegiate body, but would not be checking documents and preparing conclusions and would only take decisions on the above issues. Members of the Exchange Council (later, the Board of Directors), the regulator's representative and a member of the KASE Management Board, responsible for listing issues, were supposed to be members of this body.

As such, this competence of the Listing Commission at the initiative of the Exchange was enshrined in Article 84 of the Law *On Securities Market* in the beginning of 2007, and the structure of the Listing Commission was stipulated in a regulatory legal act of the regulator, according to which it is approved by the decision of the Board of Directors of KASE. Thus, verification of documents provided for the purpose of listing the securities, preparation of opinions on the conformity of securities and their issuer to the listing requirements and the arrangement of meetings of the Listing Commission were transferred to the competence of the Listing Department of KASE.

Originally, the Listing Commission was supposed to consist of at least nine members, then, of at least seven members. In March 2017, the amendments were made to this regulatory legal act that changed both quantitative and qualitative composition of the Commission. According to the amendments, it was established that the number of members of the Listing Committee shall be at least five and it would be formed from among members of the Management Board, the Board of Directors and representatives of the Association of Financiers of Kazakhstan. In this form, the Listing Commission operates to this day.

The significance of the Listing Commission can hardly be overestimated. Especially during those years when it was taking decisions on the admission of securities to buying on account of pension assets. From the very start, representatives of various financial and industrial groups, often competing with each other, were elected to this body, which made it virtually impossible to adopt biased decisions. The Listing Commission was truly market institution and remains so now on the emerging securities market of Kazakhstan. Each member of the Listing Commission is aware of its role, because even when a company and its securities formally comply with the listing requirements, he/she has the right to vote against the admission of securities to the Exchange, if he/she is convinced of the low investment quality of these securities or inadequately high risks of the issuer.

So, the first auction on placement of bonds of Mangystau Region in KASE trading system was held on July 7, 1999, but the results were canceled by the Ministry of Finance, because investors stated excessively high yield. Although the first step is always the hardest one, it showed KASE's full technological readiness to conduct such auctions. The second attempt of primary placement was made on July 28 and proved to be successful; the yield-to-maturity on one-year securities was 14.71% per annum.

By the beginning of 2000, three successful auctions were held on the Exchange market to place government securities of local executive authorities: the abovementioned bonds of Mangystau Region, and securities of Almaty and Astana. All of them were indexed by the change in the KZT/USD exchange rate, since they had a par value of USD 100 and were serviced in KZT at the current rate. The total amount of the issues held was equal to the equivalent of USD 7,824,000 in nominal terms, or KZT 949,662,100 in terms of the amount of funds raised¹².

The year 2000 turned out to be a time of "respite". A single auction was held in the KASE trading system to place bonds of Atyrau Region (July 7).

The secondary market for municipal bonds was not good news either. A total of 28 transactions were made at KASE with 36,580 bonds for a total amount of KZT 483.4 million, which made up only 0.108% of the total GS exchange turnover.

However, the Exchange expected a further revival of this market, because at the end of the same year and in 2001, the regions of Kazakhstan received credit ratings from leading world agencies for the first time and announced their far-reaching plans. In anticipation, the Exchange got engaged in refining the service. On August 15, 2000, a new regulatory document The Responsibilities and Rights of KASE Members of K Category with a Status of Market Maker of Bonds of Local Executive Authorities¹³ entered into force on KASE, and on September 25, a mandatory market maker was introduced for these securities and mandatory listing fee was set.

Investors were also ready for expansion of the municipal bond market. The continuous growth of the resource base of banks and assets of accumulative pension funds of Kazakhstan predetermined, on the one hand, the demand for municipal bonds, and on the other hand, the possibility of their placement at relatively low rates.

As a result, already in 2001, the volume of securities placed by the executive authorities was 8.5 times higher at par than in 2000 and 4.9 times higher than in 1999. Market capitalization reached USD 38.7 million. Borrowing terms increased significantly and resulted in the event that the issuers of all five issues placed on the Exchange in 2001 (including the newcomer – Akimat of East Kazakhstan Region) preferred a coupon mechanism of debt servicing to discount one. Compared to 1999, the cost of services (including devaluation rate) decreased almost twice.

It is worth of note that the second-tier banks were the key buyers of municipal bonds in primary offerings (70.3%), and PAMCs ranked only second (16.5%).

Obvious progress in 2001 was also observed in the secondary market for these securities. The total amount of transactions (excluding repo transactions)

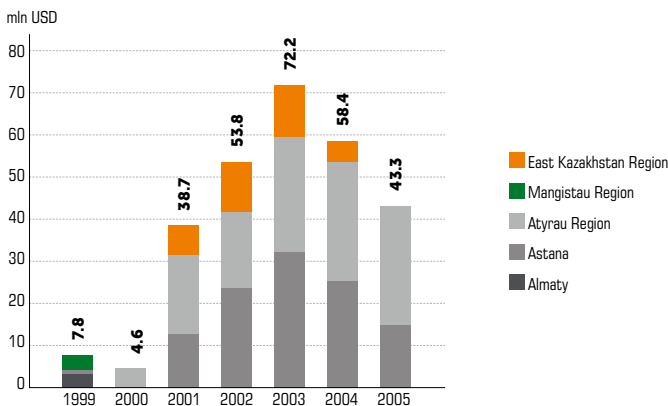
was KZT 22,014.1 million and grew 43 times compared to the previous year. However, the performances of its exchange segment were much less impressive – only 20.4% of transactions in volume terms were made through the KASE trading system, and the rest were made outside the Exchange.

In 2002, municipal bonds of four new issues issued by Akimats of Astana and East Kazakhstan Region passed the KASE listing procedure. However, unlike all previous issues, none of the new four bonds was allowed to be purchased at the expense of pension assets. This was due to the revision of the Government's attitude to this type of borrowing. In particular, in May, the First Vice Minister of Finance of Kazakhstan, Kairat Kelimbetov¹⁴, speaking at a Government meeting, said that Kazakhstan intended to reduce the amount of borrowing by local executive authorities because of the high cost of funds raised.

The signal was given, and in 2002 there was a decrease in the issuing activity of local executive authorities, on the one hand, and a drop in demand for municipal bonds in the primary market, on the other hand. The yield of bonds offered for placement under pressure from the Ministry of Finance was very low and, in the opinion of investors, did not compensate for fairly high investment risks resulting from the terms and conditions of regional investment programs of issuers.

The exchange secondary market of municipal securities contracted drastically, as well. For the whole year, only three transactions were made for the amount of KZT 85.3 million (KZT 3,087.7 million in 2001). Such a significant contraction was mainly caused by the loss of interest of PAMCs in dealing with municipal bonds.

THE DYNAMICS OF CAPITALIZATION RATE AND MARKET STRUCTURE OF KAZAKHSTAN MUNICIPAL BONDS IN 1999–2005 (AT THE END OF THE PERIOD)



These trends continued in 2003. With two new issues of municipal bonds, only recognized issuers with a positive credit history entered the market. However, only the financial consultant of Atyrau Region for the fourth issue of securities managed to obtain permission from NBRK to purchase the issued bonds at the expense of APF pension assets.

In its annual report, the Exchange named the year 2004 “the last year where it was possible to speak about any development of the Kazakh market of municipal bonds”. Despite the fact that Akimats had always been very scrupulous about their obligations to service and redeem previously issued securities (a single – purely technical – daily delay in paying on Atyrau Region bonds in 2002 was the exception), the Government’s attitude to these securities kept changing to the negative one. This was reflected in the new Budget Code of the Republic of Kazakhstan effective from January 1, 2005, according to which borrowing by local executive authorities should be carried out only in the form of receiving loans from the Government of the Republic of Kazakhstan. Essentially, this meant a ban on the issuance of municipal bonds. Therefore, already in 2004 they were not placed on KASE; moreover, out of eight issues still listed, two were redeemed. As a result, the total capitalization of the municipal bond market decreased in nominal terms by 19.2% in 2004, and by 25.8% in 2005 (after redemption of two more issues).

The first act of the history of the municipal securities exchange market ended like that, and it got continuation at a new level only a few years later – in 2010.

THE CORPORATE BOND MARKET: ON THE WAVE OF THE “BOND BOOM”

The “bond boom” that started in 2000 gained rapid momentum in the “fat years”. Throughout the following six years, the corporate bond market (both primary and secondary) remained one of the most dynamic segments of the stock market of Kazakhstan. Although in different periods, some changes in the monetary policy of the government and external environment, behaviors and preferences of its actors had their own features in response to the economic situation, the strengthening of the investment potential of accumulative pension funds was the main driver of such rapid growth.

APF assets, regularly replenished with the contributions of the Kazakhstanis, had to be constantly invested somewhere, however, with a reasonable risk, and corporate bonds were the best instrument in this regard, which, on the one hand, promised guaranteed income, and, on the other hand, provided a good premium to sovereign bonds of Kazakhstan. In addition, the money, whether directly or via the banks, went to the real sector. This had a relevant effect on the expansion of the KASE A category official list accordingly.

Higher, and higher...

In general, from the beginning of 2001 to the end of 2006, the volume of corporate debt listed on KASE grew by 70 (!) times – from KZT 25.7 to 1,788.6 billion. Taking into account Compound Annual Growth Rate (CAGR), this value doubled on average each year. Gradually, the benefits of funding through the issuance of bonds in the civilized exchange market were appreciated by everyone – mineral giants, monopolists, medium-sized industrial enterprises, and, of course, banks. The number of issuers and their securities on the official list of KASE bonds grew by leaps and bounds (from 22 at the beginning of 2001 to 89 at the end of 2007 and from 24 to 230, respectively), and the redemption of earlier issues was compensated by additional or new placements.

However, the sectoral structure of the official list of bonds gradually changed: Kazakhstan and its blue chips were well-liked in foreign financial markets due to the raw material environment, and large enterprises increasingly borrowed from abroad, while the issuing activity of mid-level companies at KASE was limited by the capital capacity of their investment programs. In the meantime, the banks were happy to use medium-term bonded loans to extend the terms and cut the costs of loans to the real sector of the economy, the construction sector and the public. In addition, the placement of subordinated bonds (especially in the early years) allowed ambitious banking players to comply with the requirements of the National Bank in terms of capitalization. As a result, having started from the second line (37.7% vs. 48.2% of oil companies) in 2001, banks very quickly turned out to be unconditional leaders in the structure of corporate debt at KASE, increasing their share in nominal terms to 87.5% in 2007.

CBonds IA and KASE

The result of the "bond boom" was that Kazakhstan had significantly outstripped Russia in the development of this market sector and this experience was of great interest to the Russian colleagues. In 2002, Sergey Lyalin, the head and owner of CBonds.ru LLC information agency (which has specialized in provision of information on the securities market that was incomprehensible for the majority at that time), visited the Third Issyk-Kul International Conference of Professional Participants of the Securities Market. Since that time, cooperation between CBonds, KASE and its subsidiary Information Agency Irbis began. The exchange of information on the bond market was established, KASE representatives participated in bond congresses of the CIS and the Baltic states regularly held by CBonds in various countries. Cbonds.ru LLC became an official vendor disseminating KASE information since 2003; it always has been not only a party to a contract, but a real partner, always ready to extend cooperation

KASE and CBonds together have organized and partnered in a number of events in Kazakhstan, including the Bond Congress of the CIS countries (May 2005, Almaty), Kazakh Congress of Securities Market Participants (March 2008, Almaty) and XV CIS and Baltic States Bond Congress (May 31 – June 1, 2018, Astana).

Pension Vacuum Cleaner

The inclusion of new bonds in the lists of securities had a decisive impact on the growth of corporate bond capitalization. For instance, in 2001, an increase in corporate debt placed on KASE was almost completely secured by new issues listing specifically for A category. The temptation to gain access to pension assets was so great that strict requirements did not seem so frightening. Especially since, once in A category, the issuer could figure on a simplified procedure and benefits for further issues. For this reason, out of 27 titles of securities listed in 2003, only nine belonged to new issuers.

Nevertheless, despite intense interest in their money, pension funds increasingly felt the lack of instruments.

The predominance of demand over the supply of corporate bonds, on the one hand, allowed issuers, as in the case of government securities, to systematically increase the circulation time and reduce the yield on their bonds. Although this yield remained higher than that of sovereign Eurobonds. For example, at the peak – in 2002 – corporate securities provided their holders with a premium of 400–600 basis points over the yield of sovereign debt.

On the other hand, the development phase of APFs did not add any liquidity to the secondary trading in corporate debt securities. *Bolat Zhamishev*, who headed FSA in 2004–2005 and now chairs the Management Board of the Development Bank of Kazakhstan, while recalling that time, aptly described the work of APFs and PAMCs in the market as follows:

“Although APS contributed to the development of the stock market, it had to mature first. And it takes at least 20 to 25 years for the cash inflows in a form of pension contributions to be aligned with outflows in a form of pension benefits. Otherwise, the pension system plays the role of a vacuum cleaner – investors will hold securities to maturity and have a negative effect on liquidity in the stock market.”¹⁵

And yet, activity in the bond sale and purchase sector was generally higher than in the equity market and continued to grow from year to year. For example, in 2004, the number of transactions with bonds at KASE increased more than one and a half times to 1,710, the volume of transactions increased by KZT 21.03 billion (1.3 times) to KZT 97.9 billion, and the number of titles of bonds involved in transactions, reached 83 vs. 57 in 2003.

The bonds, with which the so-called securities specialists dealt in addition to market makers mandatory for A category, generally had the greatest liquidity. The Exchange set much stricter requirements for the spread between mandatory quotations than to ordinary market makers. These requirements were constantly growing. If in 2001 the maximum spread for specialists should not exceed 3% of the value of the purchase quotation, then in 2005 it was narrowed down to one percentage point. In exchange, this category of market makers could figure on the most favorable working conditions on the Exchange and receive benefits for commission fees.

In the Wake of the Tenge Exchange Rate

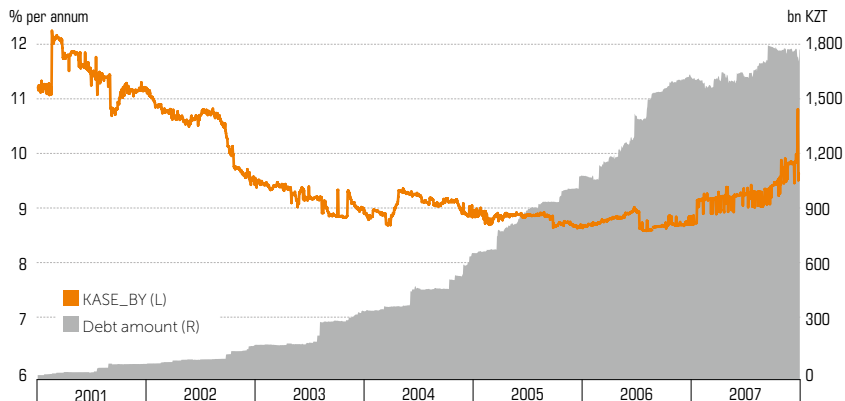
The yield and popularity of certain types of corporate bonds traded on KASE had a direct connection with the situation in the money and currency markets. By the way, starting from March 11, 2001, the Exchange calculated and published three indices daily: KASE_BC ("net price"), KASE_BP ("gross prices") and KASE_BY (weighted average yield).

Initially, international corporate bonds and non-indexed dollar securities were the main drivers of activity in the market. In particular, in 2002, large issues of international corporate bonds, such as Kazkommerts International B.V., Development Bank of Kazakhstan, TuranAlem Finance B.V, Kazakhmys Corporation brought to the Exchange had a strong influence.

However, already in 2003, the steady strengthening of the tenge against the US dollar in the domestic market provided tough conditions for investors. The most bonds traded on KASE were US dollar-based or securities indexed by the KZT/USD devaluation rate. The rise in the price of corporate debt circulating in the market as a percentage to the par value, caused by a shortage of investment facilities, almost did not compensate for the losses associated with the strengthening of the tenge against the US dollar. As a result, the actual increase in the "gross" price in tenge of the averaged currency bond was often negative even for the most KASE-traded securities. Yield of APFs started falling drastically.

Decreased appeal of the foreign currency bonds and exchange rate connected tenge bonds forced issuers to issue non-indexed bonds denominated in KZT, or securities with the yield protected from inflation. If the par value of the new bonds, as before, was indexed by the change in the KZT/USD exchange rate, then the majority of issuers had to introduce protection of investors'

AMOUNT OF OUTSTANDING CORPORATE DEBT AND YIELD INDEX OF CORPORATE BONDS IN 2001–2007

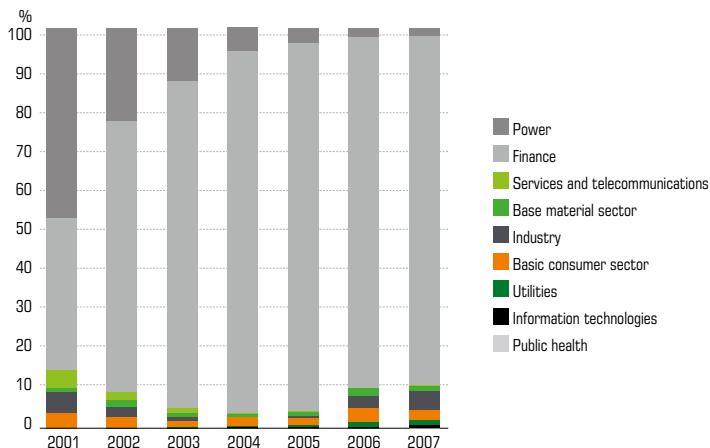


income from the tenge strengthening into the terms and conditions of the issue of bonds. In other words, if the KZT/USD exchange rate, which was valid at the start of circulation of bonds, was higher than the current exchange rate, the indexed par value of these bonds, serving as the basis for calculating the amount of accrued interest, was calculated not at the current exchange rate, but at the exchange rate existing at the start of circulation of securities. This approach to issuing new bonds became a feature of 2003 and allowed investors to diversify their risks.

In 2004, the investment credit rating assigned by Standard & Poor's to Kazakhstan in May had the greatest impact on the trend of bond yields at KASE. As analysts of the Exchange noted, "it was that very circumstance that turned the KASE_BY index down after a short April rally caused by temporary "stocking" of the market. The trend reversal was largely caused by the change in quotations of international bonds of Kazakh issuers affected much by assignment of the rating."¹⁶ Although new bonds of this type continued to replenish the official KASE list of A category, this was primarily due to the need to meet the formal requirements of the regulator. They practically did not use real demand, and there was no liquidity on them. This trend continued in 2005 – market actors showed the greatest interest in bonds, the coupon rate of which depended on the level of consumer prices in Kazakhstan.

The favorite topic of conversations in the market at that time was reproaches to pension asset managers for poor investment results, and representatives of APFs complained about the lack of high yield of securities and possible ways to increase it.

INDUSTRY STRUCTURE OF THE CORPORATE DEBT TRADED ON KASE IN 2001–2007



The year 2006 was remembered by the appearance of new types of bonds at KASE. For the first time, foreign private debt securities were included in the trade lists of the Exchange – bonds of JP Morgan Chase Bank, National Association and Merrill Lynch & Co., Inc., as well as the first infrastructure bonds of Doszhan Temir Zholy JSC and Batys Transit JSC issued as part of implementation of concession projects with state participation.

The latter were designed specifically for placement among APFs, and some market players built certain hopes on the development of this instrument. However, the subsequent events of the following critical stage of the history of Kazakhstan and the Exchange in many ways dispelled these expectations.

Growing Pains

The rapid growth of the corporate bond market was not without unpleasant precedents, since a huge amount of pension money attracted not only fair borrowers. The situation with the bonds of Shakharmunaymaz officially listed in A category on the Exchange on January 19, 2001 was a bright, however,

Corporate Bond Market Indicators

KASE began publishing the corporate bond market indicators, so-called KASE_B* series indices, on March 11, 2001.

These indicators demonstrated the weighted average yield of the debt instruments of the highest quality traded at KASE (**KASE_BY indicator**), and the change in their prices excluding accumulated interest – net prices (**KASE_BC Index**) and prices with accumulated interest and coupons paid – gross prices (**KASE_BP Index**).

The key selection criteria for bonds for the representative list to calculate indicators of the KASE_B* series were as follows:

- whether the bonds are issued in accordance with the laws of Kazakhstan;
- whether the Exchange has information on the number of the bonds placed;
- whether the bonds have a market maker;
- whether the bonds have non-indexed face value;
- whether the bonds or their issuer have a certain rating score;
- whether the bonds are listed bonds in the KASE trading system in "net" prices; and
- whether the issuer has outstanding debt on coupon payment and/or principal debt on the bonds issued.

The calculation of KASE_B* series indicators was discontinued in October 2017 due to the introduction of a new structure of the official list of securities and the need for a significant change in the criteria for inclusion of bonds in the representative list of indicators. To replace the indicators of the KASE_B* series, new indicators were developed for the basic platform (KASE_BM* series) and the alternative one (KASE_BA* series).

not light spot in the history of those years. It was the first time in the practice of the Exchange, when KASE initially made every effort to prevent this from happening, since it saw significant risks in the business model of a potential issuer. However, the assets, capital and other performances of the company formally met the listing requirements existing at that time, government officials intervened in the case, and the listing was nevertheless carried out.

Already after the inclusion of these bonds in the official list, the Exchange from time to time published warnings on the website that investments in the company's securities bore very high risks, with a highly potential default. Unfortunately, on the wave of the market euphoria, these calls were not widely heard – by the end of 2001, 46.7% of its total bonds for more than six million US dollars were in the portfolios of APFs.

In March 2002, the Exchange Council once again tightened the listing requirements in A category, and Shakharmunaygas did not fit into them: the company could not reach one billion tenge in the annual sales volume. It did not even provide a plan to increase this indicator to the required level, which would give it a delay on the application of new listing requirements. In August 2002, the Exchange Council made a decision, according to which if Shakharmunaygaz OJSC did not bring its indicators to normal in six months, its bonds would be transferred from category A to B. The company, in turn, brought an action challenging the legality of such a decision, and started a series of trials that lasted for more than one year. In the end, the company made a default, which became the first in the history of the Exchange, this case turned out to be a great lesson for stockbrokers, for the regulator, and for investors.

STATE-OWNED STAKE TRADE SECTOR: NOT ONLY FOR “STRATEGISTS”

In 2001–2007, following the entities subject to mass privatization and second-tier companies, state-owned blue-chip stocks of Kazakhstan finally got to the sale in the organized stock market.

At this point, state-owned stake (SOS) trading at the KASE platform was regulated by an internal document of the Exchange approved by the State Property and Privatization Committee of the Ministry of Finance of the Republic of Kazakhstan, State-Owned Stocks. The Procedure for Admission to Trading and Settlements Based on the Trading Results. In accordance with this document, SOS were divided into two types:

- SOS that are nominally held on a depo account with the Central Securities Depository. They were designated in the trading system by a code starting with “NZ” (“NZ” series), and their sale was allowed only with preliminary blocking on the CSD accounts.

IFI BONDS MARKET

The growth of pension assets had a positive effect on the corporate bond market in 2001–2007. However, there was a need for market actors to diversify their portfolios. In this regard, UAPF received a proposal to organize trading in bonds of International Financial Institutions (IFIs) at KASE, and the Fund expressed its intention to act as a supplier of these securities to the domestic market. The Exchange took the necessary measures to launch this sector, which was ultimately reflected in the Rules for the Listing of Securities of International Financial Institutions on the Exchange approved by the Resolution of the NSC Directorate on January 31, 2001 and approved by the Resolution of KASE Members' meeting on January 17. The Rules stipulated that securities of IFIs were listed on the Exchange by the decision of the KASE Management Board pursuant to the request of the listing initiator – an Exchange member of K category, and if there was a request from a KASE member to perform the functions of a market maker of securities to be listed. The maintenance of regulated minimum spreads at compulsory quotes in the KASE trading system was a prerequisite for market makers. According to the Rules, eight institutions were identified as IFIs, including the Asian Development Bank, the African Development Bank, the Bank for International Settlements, the European Bank for Reconstruction and Development, the Islamic Development Bank, the Inter-American Development Bank, the International Finance Corporation and the International Bank for Reconstruction and Development.

IBRD bonds of two issues were the first ones to be listed on KASE in February 2001. A week later, the notes of IFC added as well as IBRD Eurobonds from September 20. UAPF acted as a market maker for all these securities.

Despite the insignificant share of the volume of trading in IFI bonds from the total exchange turnover in that year, the results for the sector itself were encouraging. A total of 41 transactions were made in 2001 for a total of KZT 862.9 million or USD 5,902,500. February and September were the most active months – when new instruments were listed.

Having tested this sector in 2001, market actors almost never traded in IFI bonds in the following years. After a two-year lull in 2002–2003, only a few transactions per year were made at KASE from 2004 to 2006. The annual reports stated the growth of professionalism of PA managers and the establishment of contacts with foreign brokers, which allowed PAMCs to trade in IFI bonds without Kazakh intermediaries as the main reason for this.

In just seven years, 46 transactions totaling KZT 902.7 million or USD 6,193,400 were made at KASE, and the listing initiators brought seven bond issues of four IFIs for a total value of USD 3,007 million and 3 million Deutsche Marks to the site.

- SOS that were not transferred to the account with the CSD. Their code began with "Z" ("Z" series), and preliminary blocking of shares before the sale was not required.

The first SOS of Z series was sold on KASE on November 5, 1997 as part of the mass privatization of small and medium-sized companies. For SOS of this series, a separate trading platform was opened at the Exchange, where transactions were held in the automated order satisfaction mode. At the same time, the participants quoted a stake in a single lot, indicating the full price. This excluded the very possibility of buying SOS at retail by several buyers. In total, since 1997, 27 SOS of Z series were sold on the Exchange for a total amount of KZT 2,522.5 million (USD 20.5 million). In 1999, the mass privatization program was almost discontinued due to the transfer of most of the entities of such privatization to communal ownership. However, akimats did not demonstrate any interest in selling newly acquired assets through the Exchange. The last stake of "Z" series – SOS of National Legal Service CJSC – was sold at KASE on December 29, 2000, and this was the only transaction with SOS in 2000.

The NZ SOS appeared on KASE on November 20, 1998. In the context of the global financial crisis, Kazakhstan was in dire need of replenishing foreign-exchange reserves, which could be implemented through privatization to a large extent. At the same time, the outflow of capital of portfolio investors forced the government to focus on strategic investors. The first NZ stocks were brought to the Exchange through the Non-Listed Securities sector, and as a rule, they were second-tier enterprises technologically related to blue chips, which means they could be interesting for their new owners. On December 1, 1998, the Department of State Property and Privatization of the Ministry of Finance held a tender for the right to place SOS through an organized securities market, where broker-dealer companies took an active part. This led to a drastic increase in SOS trading, as a result of which, in 1998, the total volume of transactions in this financial instrument reached USD 22,690,300. Withdrawal of quite interesting stakes caused market activation. The daily quotation of stakes led to the fact that trading turned into real trading, and broker-dealer companies had new clientele. At the same time, the NGS market revived, the number and volume of Exchange transactions started growing.

The echoes of this revitalization were observed at KASE in the first two quarters of 1999. However, by this time the peak of the issues with replenishing the state budget had been passed, and on June 1, 1999, the Government adopted Resolution No. 683 *On Approval of the Privatization Program and Improving the Efficiency of State Property Management for 1999–2000*. On the one hand, the development of this document led to the closing up of the mass privatization program and stagnation of the SOS sector at KASE in the following two years. On the other hand, in the document, the state announced its intention to complete the privatization of blue chips, whose shares were (or could be) listed as A category of the Kazakhstan

Stock Exchange and circulated in sufficient volumes in the domestic and/or international securities markets. As part of the second stage of blue chip privatization, the Government focused particularly on attracting additional strategic investors, which were recognized as operators in the relevant sector of the economy, to these companies.

In 2001, these intentions started coming true. The Ministry of Finance decided to sell two large blocks of shares of Kazakhmys Corporation through the KASE trading system through open trading. On November 19, domestic investors were offered a 10% stake, which was sold as a single lot. And on November 20, the trades in 5% SOS opened, where only the entities of the Kazakhstan pension market could take part. For sale, this block was divided into 245 indivisible lots of 1,000 shares each and the 246th lot, consisting of 577 shares. Following the results of the trades on November 19 (with two potential buyers participating), the 10% stake was bought out by Kazakhmys Corporation OJSC through an authorized broker for USD 63 million. At that time it had been the largest transaction ever held at KASE in the entire history of its existence.

Trading a stake intended for APF was less effective. The price requested by the state for ordinary shares of Corporation Kazakhmys OJSC turned out

THE MOST SIGNIFICANT SOS SALES AT KASE IN 2001–2007

| Trading date | Issuer's short name | Number of shares in SOS | Part of total number of shares (%) | Price per share (weighted average price) | Price | |
|-------------------|----------------------------|-------------------------|------------------------------------|--|----------|---------------------------|
| | | | | | mln KZT | Total stock thousands USD |
| 19.11.01 | Kazakhmys Corporation OJSC | 491,153 | 10.00 | 128.58 | 9,384.8 | 63,150.5 |
| 20.11.01 | Kazakhmys Corporation OJSC | 17,000 | 5.00 | 122.16 | 308.4 | 2,076.7 |
| 27.12.02 | Kazakhmys Corporation OJSC | 982,307 | 20.00 | 29,179.00 | 28,662.7 | 184,018.6 |
| 27.12.02 | Kazakhmys Corporation OJSC | 228,577 | 4.65 | 10,300.00 | 2,354.3 | 15,115.2 |
| 29.05.03 | CNPC-Aktobemunaygas OJSC | 2,236,619 | 22.61 | 9,100.00 | 20,353.2 | 135,156.6 |
| 29.05.03 | CNPC-Aktobemunaygas OJSC | 98,904 | 1.00 | 9,110.00 | 901.0 | 5,983.2 |
| 29.05.03 | CNPC-Aktobemunaygas OJSC | 98,904 | 1.00 | 9,110.00 | 901.0 | 5,983.2 |
| 29.05.03 | CNPC-Aktobemunaygas OJSC | 50,226 | 0.51 | 9,110.00 | 457.6 | 3,038.4 |
| 26.01.04 | UTMP* | 107,910 | 10.00 | 7,202.00 | 777.2 | 5,571.1 |
| 28.01.04-30.01.04 | UTMP | 59,350 | 5.50 | 9,133.33 | 540.9 | 3,880.1 |
| 15.12.04 | Alliance Bank JSC | 12,955 | 1.99 | 9,600.00 | 124.4 | 956.5 |
| 05.08.05 | Kazzinc JSC | 206,436 | 1.00 | 3,308.50 | 683.0 | 5,038.3 |

* Ust-Kamenogorsk Titanium Magnesium Plant OJSC

to be too high for PAMC, which, moreover, had already 'tasted' securities with a fixed and guaranteed income. On November 20, only 17 lots (17,000 shares) were sold at the price of 122.16 USD per share. The amount of the transaction was barely more than 2 million USD. Despite the fact that attempts to sell the remaining lots were made at KASE until December 4, 2001, the parties could not agree on the price. And in 2002 this stake (the remaining 4.65%) was sold to a consortium of portfolio investors led by the Russian Aton. At the same time, the Government sold its last 20% stake in Kazakhmys to the strategic investors, earning KZT 31 billion for it, which was equivalent to USD 199.1 million.

In the future, blue chips SOS were rarely offered for sale, but these were very attractive stakes. In 2003, four effective transactions were made with shares of CNPC-Aktobemunaygas OJSC; in 2004, Ust-Kamenogorsk Titanium Magnesium Plant OJSC and Alliance Bank JSC; and in 2005, Vasilkovskoye Gold JV OJSC. The last SOS sold at KASE in the "fat years" was the share in Kazinc JSC, which was bought out in two indivisible lots on August 5, 2005. In total, since December 15, 1998 (it was then that the first trades of SOS of this series were held at KASE) 34 NZ stocks for KZT 66,907.2 million (USD 447.4 million) were sold at KASE.

Of course, all these stocks were primarily focused on strategic investors, and the sale of such stocks solved special narrow tasks, ranging from diversifying the structure of shareholders to marketing goals. Nevertheless, part of the shares was freely circulated on the Exchange; privatization supported the interest of portfolio investors, and prices fixed by the results of trading in large SOS gave the market a signal that the most interesting listing companies were clearly undervalued. It was also important that, by organizing trades in SOS, the Exchange gained experience, used as early as 2007, when another form of selling de facto state-owned shares appeared in the market.

STOCK MARKET: FROM SKEPTICISM TO EUPHORIA

Development of the equity securities exchange market in 2001–2007 can be divided into two periods. The first period from 2001 to 2003 was often called by KASE analysts as the period of broken hopes and unimplemented plans. By that time, there were enough prerequisites for the qualitative growth of the stock market: institutional investors represented by pension funds and banks had the necessary assets, and international investors also showed some interest. The Exchange as a trading platform had experience in organizing the placement of securities and settlement of transactions. The market infrastructure, which was represented by the Central Securities Depository, registrars and broker-dealer companies, was fully formed.

However, despite the understanding that the market could not exist without the corporate sector represented by shares of large private companies, the segment of shares remained narrow and "schematic". The privatization of blue chips reached KASE in a very truncated form, and the inclusion of small and medium-sized companies listed as part of mass privatization on the Exchange was not a game-changer. **Azamat Dzholdasbekov** said in his interview to *The Securities Market* magazine in July 2002: "The sale of shares of the companies, which are not national companies, does not play any role for the stock market. The maximum that the stock market can receive from the sale of these securities is loading the KASE trading system in case of privatization of these organizations through an organized securities market. But this does not seem particularly interesting. As the practical experience shows, the shares of small enterprises can "hang out" for months on the KASE's trading platform without finding a buyer."

The capitalization rate of the stock market grew steadily, repeating the general trends of other sectors, but this happened, as a rule, due to the inclusion of new securities in the official KASE lists and an increase in the authorized capital of listed companies. For example, in 2002 alone, the volume of registered share issues increased by 157.1% compared to 2001. However, in terms of price, the market remained completely detached from the financial condition, success or failure of the issuing companies, as well as the state of the economy of Kazakhstan as a whole. Despite the presence of stock market makers, the low liquidity of shares still scared off potential investors, who at best considered equity securities as an instrument for repo transactions. KASE used the KASE_Shares Index as a price indicator of the exchange stock market. This index was calculated by the Exchange on a regular basis from July 12, 2000 and reflected the dynamics of demand quotes for shares of the A category official list, taking into account the market capitalization rate of their issuers. In the early years, its behavior was characterized by increased volatility and did not have any pronounced trend. As a rule, price movements were shaped by the interests of shareholders, who used shares as a pledge instrument or a means of mutual settlements. This was evidenced by the growth in the volume and share of non-market (direct) exchange transactions with shares. In 2003 alone, such transactions accounted for 75.6% of the exchange turnover at KASE (USD 199.1 million).

In 2004, which can be considered as the beginning of the second period of the development of the stock market in the "fat years", the situation with contractual transactions became worse. At the same time, a clear difference of that year from the previous ones was the growth of the sector's capitalization rate due to the change in the price of the shares traded. As estimated by the Exchange, the weight of this factor reached 72%. This indicated a significant growth potential for the majority of shares of Kazakhstan issuers, which were significantly undervalued in the market makers' quotes. In 2005 the real price rally started in the stock market. The dynamics of quotations of individual securities was so fast that in 2006 it was possible to talk about the overvalued and overheated market.

Kazakhmys Factor

The sale of state-owned stock of a number of large companies of Kazakhstan at KASE took a special place in the history of the “fat years”. Participation in SOS trading required the market actors to redistribute large sums of money, which, in turn, caused the activation of exchange trading in securities in general. The results of the trades gave new, more realistic, price benchmarks for further trading in shares of not only SOS issuing companies, but also other enterprises of the same sector of the economy.

For example, in 2001, the new price of ordinary shares recorded as a result of bargaining at the sale of a 10% SOS of Kazakhmys Corporation OJSC led to an increase in the capitalization rate of companies on the official list of the Exchange by 37.7% or USD 391.5 million. Moreover, after that the price of preferred shares of Corporation Kazakhmys OJSC also increased. In 2002, the sale of the state’s recent stakes in this company and the issuer’s change in the structure of the authorized capital stock led to intensified trading in ordinary shares of the copper giant in the fourth quarter, including at the request of individuals. Over the next three years, Kazakhmys shares remained perhaps the only instrument most actively traded on the exchange platform. The behavior of their quotes (and, as a result, prices) in most cases had a decisive effect on the dynamics of the KASE_Shares Index. In many respects the activity of NGS trading at KASE was supported by the liquidity of this particular instrument. Based on the results of 2004, its share in the exchange turnover of the secondary NGS sale and purchase market amounted to 19.2%, and the secondary shares sale and purchase market amounted to 33.9%

Ironically, that very year Kazakhmys Corporation JSC was reorganized into an LLP and some time later became a part of the newly formed Kazakhmys PLC holding with a UK residence. As a result, the Kazakhstan stock market lost for more than two years (before the ordinary shares of Kazakhmys PLC, which was later reorganized and renamed to KAZ Minerals PLC, were listed at KASE) not only nearly a billion US dollars in capitalization of the domestic stock market, but also the instrument that was the most liquid non-government securities and a catalyst for the general activity of investors for several years.

From Undervaluing to Overheating

Even having left the Kazakhstan stock market, Kazakhmys retained its indirect influence. In September 2005, Kazakhmys PLC became the first company with Kazakh assets to place its shares on the London Stock Exchange (LSE), and as early as December 2005 it was included in the representative list of the leading LSE Index – FTSE 100. The high price and enthusiasm of foreign investors buying the shares of Kazakhmys and Kazakhaltyn Mining and Metallurgical Concern JSC, which followed it to the London platform, became another proof of the high speculative potential of securities of other companies listed on KASE. The undervaluation of the Kazakhstan market in mandatory quotations of market makers made it possible for arbitration,

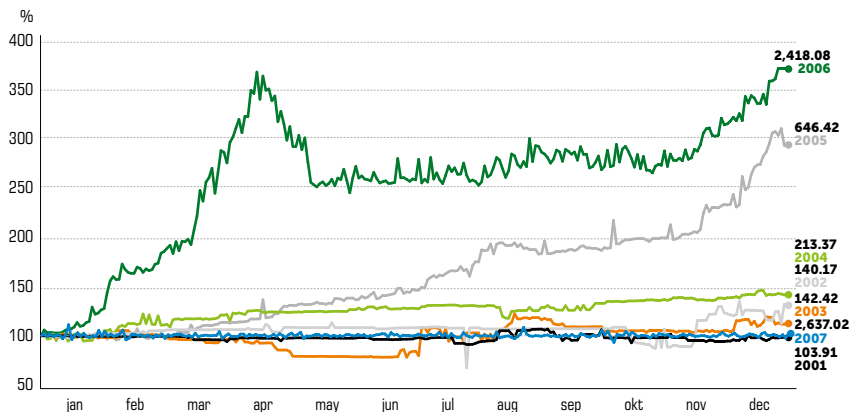
and brokerage companies and their clients – individuals working on the Kazakhstan Stock Exchange – snatched this opportunity. At least, stock market experts said this factor was one of the reasons for the drastic growth of KASE_Shares Index.

The turning point in the situation in the stock market occurred in 2004, following which KASE_Shares Index grew by 42.7% from 149.55 to 213.37 (+63.82 basic points). Based on the results of 2005, one could talk about the Kazakhstan's organized stock market moving to a qualitatively new level. The trading volume exceeded USD 1 billion. The KASE_Shares Index showed an 11.1 times increase (for the period from January 2005 to December 2006). The stock market became more attractive for retail investors, whose share reached 38% of the gross turnover of trading in shares. The positive dynamics of prices for listed shares affected the dynamics of the capitalization rate, which showed a threefold increase in 2005 (up to USD 10.5 billion) and reached a record level of USD 56.6 billion in December 2006.

At the same time, a powerful revival in the stock market and increased attention from ordinary Kazakh investors had a weak spot – the list of first-class issuers was still limited, and the share of their stock in free circulation was negligible. The speculative excitement created around a limited number of shares, the use of a "direct" repo to play in order to raise their market price and the ability to 'rock' the security with relatively small transactions caused the analysts to have a well-founded fear of "overheating".

Andrey Tsalyuk explained in April 2006: "The main driver of the Kazakhstan stock market is still speculative interest. Shares are bought in the hope of an increase in their market value rather than in a desire to receive guaranteed dividends... It is not currently profitable for anyone to make the stock market collapse. Institutional investors have been involved in the process. KASE_Shares

THE DYNAMICS OF KASE_SHARES INDEX IN 2001–2007



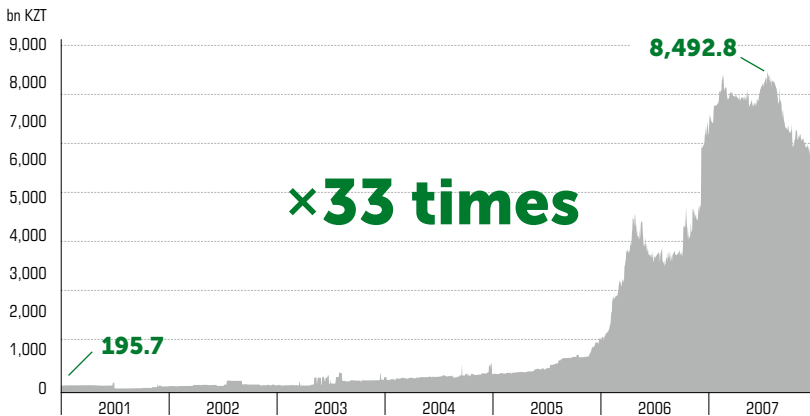
Index continues going up. But when it grows, the degree of risk of this kind of investment increases. I believe that, to put it mildly, it is no longer worth it talking about the undervaluation of the shares of most companies. When everything is traded for a price several times higher than its book value, it should be alarming. But the market receives news and recommendations that have a positive effect on prices... Unlike the "ordinary people", professional market players are trying to analyze the situation and consider their risks. Therefore, the demand of professionals strengthens the walls of the bubble."¹⁷

But the rally continued. The stock exchange market in 2006 looked the most attractive for investors over the entire history of its existence. By the end of the year, the value of the KASE_Shares Index reached 2,418.08 with an annual growth by 3.8 times. This gave reason to talk about the Kazakhstan's organized market of equity instruments as one of the most profitable markets in the world in 2006. By July 2007, its capitalization reached a peak of USD 70 billion, and only from that moment the stock market began to plunge into the "red zone".

IPO as a Market Capacity Measurement Tool

The speculative nature of the price boom in the KASE stock market with low liquidity caused certain skepticism among potential issuers regarding its readiness to "digest" the placement of large blocks of shares at a decent price. However, at the end of "fat" years, an event occurred that called into question the validity of such a skeptical assessment. In September 2006, KazMunayGas Exploration

THE DYNAMICS OF STOCK MARKET CAPITALIZATION IN 2001–2007



Production JSC, one of the three largest oil producers in Kazakhstan, conducted an IPO, which was held simultaneously on LSE and KASE. The initial placement proved to be very successful – in total, the issuer managed to attract more than USD 2.03 billion. At the same time, Kazakh investors bought 67.4% of all offered shares. The subscription was conducted by Visor Capital, which received the status of the lead manager of the offer of new shares of the company in Kazakhstan, i.e. underwriter. The subscription in the domestic market took place not at the Exchange, since no purchase orders for shares were sent to the KASE trading system. This practice appeared later, when implementing the People’s IPO program. However, the KASE infrastructure was used for settlements. The volume of placement transactions, which had passed through this infrastructure, amounted to more than KZT 1.5 billion, while the price for one share was KZT 11,163.39. About 9.2 million shares were placed among investors who had previously owned bonds of the subsidiary financial company KazMunayGas EP JSC, 7.4 million shares were acquired by 15 Kazakh pension funds and pension assets management companies, and the remaining 1.3 million were divided among other investors on a pro rata basis. At the same time, there was no large-scale road show in Kazakhstan to attract retail investors.

According to **Bulat Babenov**, Vice-President of the Exchange at that time and now a member of the Board of Directors of Tsesna Capital JSC, KASE worked out the placement perfectly:

“We had no particular problems with the organization of trading. By that time, the technologies of initial placement at special trades and the subscription method had already been tested, bonds were successfully placed. New was the fact that it was a large-scale initial public offering and synchronization with London. For the Exchange, this placement meant the hope that other leading Kazakh companies would place shares in the open market. Unfortunately, in future, our hopes, to put it mildly, were not fully justified.”¹⁸

The interest in oil blue-chip securities remained unsatisfied. It was already in the course of the first trading in KMG EP securities in the KASE secondary market, that the total volume of transactions exceeded KZT 156 million. The closing price for shares for the latest transactions made was KZT 12,600 per share, which was 12.9% higher than the price of placing shares in the domestic market as part of the IPO. Such a starting bid demonstrated high liquidity of the securities.

The market, professional actors, institutional and retail investors proved that they were quite ready for the transition from speculative games to serious trading. And IPO of KMG EP allowed getting an idea of the capacity of the Kazakhstan’s market for the first time. Another question was how well the companies were prepared to enter KASE. However, the London IPOs of the two largest STBs of the country – Kazkommertsbank JSC and Halyk Savings Bank of Kazakhstan JSC – held in the same 2006, made this question more rhetorical and confirmed Azamat Dzholdasbekov’s thesis made four years before that the qualitative growth of equity KASE market required to sell shares of national companies.

REGULATION AND LEGISLATION OF THE SECURITIES MARKET: TRANSITION TO A NEW LEVEL

The period from 2001 to 2007 for the securities market was marked by changes in the regulatory and legislative framework.

A new system of state regulation of financial institutions, providing for the consolidation of all supervisory and regulatory functions within a single specialized authority, started developing in Kazakhstan in 1998. Taking such a political decision, the government focused on the estimates given by leading international experts who believed that for countries with a small financial system, where a financial conglomerate operated in different market segments, the establishment of a single financial supervision authority was much more preferable.

For several years, the National Bank received the functions and authorities of the Insurance Supervision Department of the Ministry of Finance of the Republic of Kazakhstan to supervise the insurance market (1998), the National Securities Commission of the Republic of Kazakhstan to regulate the securities market (2001), and the Committee on Regulation of the Activities of Accumulative Pension Funds of the Ministry of Labor and Social Protection of the Population of the Republic of Kazakhstan to regulate the activities of accumulative pension funds (2002). At the first stage, the Financial Supervision Department of the National Bank of Kazakhstan, which was established in September 2002, succeeded the functions of these organizations. On January 1, 2004, a separate Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations was established, which reported directly to the President of Kazakhstan. The main goal of the state regulatory reform was the creation of an effective and independent system of consolidated supervision in order to improve the level of protection of the interests of consumers of financial services and develop a stable infrastructure of the Kazakhstan's financial market.

For this purpose, FSA was given the following tasks: 1) set standards for the activities of financial organizations, create incentives in order to improve the corporate governance of financial organizations; 2) monitor the financial market and financial organizations in order to maintain the stability of the financial system; 3) concentrate supervision resources on the most exposed areas of the financial market in order to maintain financial stability; 4) promote the introduction of modern technologies, ensure the completeness and availability of information concerning the activities of financial organizations and the financial services they provided for consumers.

In turn, the National Bank of the Republic of Kazakhstan, like the central banks of developed countries, concentrated exclusively on the exercise of classical functions.

The legislative framework underwent significant modernization during this period. The most important event of 2003 was the adoption of two laws defining the legal infrastructure of the stock market – *On Joint-Stock Companies* and *On the Securities Market*, which replaced the laws of the previous generation with the same name (1997–1998). Yelena Bakhmutova, Azamat Dzholdasbekov, Natalya Maximova, Murat Baisynov and Mariya Khadzhieva took an active part in development of the laws.

The most significant changes introduced by the Law *On Joint-Stock Companies* included the following:

- Eliminate division of joint-stock companies into open and closed ones. The law provided for the possibility of establishing a joint-stock company of a single type, similar to the previously existing type of open joint-stock company.

- Increase the size of the minimum authorized capital stock to KZT 43,600,000.
- Eliminate the term “face value of shares”, which had been used only to form the authorized capital stock by the founders.
- Eliminate the possibility of issuing shares without registering an issue prospectus and placing the shares in closed and private ways.

In addition, the 2003 Law set a number of new requirements to joint-stock companies, such as: establish an internal audit service; provide material information relating to the company’s activities to shareholders and the competent authority; disclose information concerning affiliates. Thus, the new legislation made a distinction between the founders of joint-stock companies, who deliberately chose this form of doing business to enter the stock market, and those, who – while establishing the company – did not intend to attract a wide range of investors. It would be easier for the latter to operate as partnerships, for which legislation was more liberal. As a result, the requirements for the authorized capital stock and the operation of JSC led to a reduction of the number of joint-stock companies, which gradually decreased from about 5,000 to 1,500.

The Law On JSC and subsequent amendments to it attempted to introduce elements of self-regulation in joint-stock companies, in particular, the Corporate Governance Code. To facilitate the preparation and implementation of the corporate governance code for joint-stock companies, a workgroup of the Association of Financiers of Kazakhstan with the participation of FSA prepared a draft Corporate Governance Code, which was adopted at the first meeting of the Council of Issuers on February 21, 2005. Subsequently, at the level of subordinate

legal acts, the requirement was set for listed companies of the highest category to approve a corporate governance code containing the provisions of this model Code by a general meeting of their shareholders on or before October 1, 2006.

In turn, the Law *On the Securities Market*, adopted on July 2, 2003, got more details and united almost all the regulation of the stock market. Considering the changes that had taken place in the market since the adoption of the first version, it had improved the rules governing the procedure of issuance, circulation and redemption of securities, registration of transactions with the securities, establishment and operation of professional market actors and organizations that made up the infrastructure of the securities market, legal status and the competence of the regulatory authority. It provided for a number of prohibitions and restrictions to avoid any abuse or unfair actions, aimed primarily at ensuring the rights to receive income on securities, acquaintance with information concerning issuers of securities, protection from insider transactions.

Another important regulatory act adopted in 2004 was the new version of the Law of the Republic of Kazakhstan *On Investment Funds*, through which a new group of investors appeared in the market, in addition to the main institutional investors – STBs and APFs. Mitigation of excessive regulatory standards and the abandonment of the system of organizing investment funds in the form of full-fledged joint-stock companies led to the rapid development of open-end funds. If by the end of 2004 only two OEFs were registered in Kazakhstan – Compass Portfolio Investment and Compass Direct Investment, then by the end of 2007, 183 open-end funds were operating in the country, including 146 closed funds, 19 open funds and 18 interval funds. Their total assets amounted to almost KZT 200 billion.

People's IPO Prototype

The idea of selling the shares of national companies was laid down in the Program for the Development of the Securities Market of the Republic of Kazakhstan for 2005–2007¹⁹, which provided for the transfer of SOS of Kazakh companies and their subsidiaries to the management of the state-owned holding company with the subsequent sale of some of them in the domestic organized market. The holding, which received the loud name “Samruk”, was established on March 13, 2006 and already in September of the same year it conducted the first experiment to place 4.6% of the state-owned stake in Kazakhtelecom JSC. It is noteworthy that it was decided to sell 90% of this stake by subscription among the population in the unorganized market, and to offer the remaining part to APFs through the Exchange.

The subscription among individuals was held through the offices of Kazpost JSC from November 30 to December 10, 2006. One could claim for an unlimited number of shares at a price within the range between 25,000 and 33,000 KZT per share in a single order. More than 6,800 orders were received from individuals, of which 6,477 were accepted. The number of shares was 2,943,575 units, i.e. demand exceeded supply by 6.5 times. The average placement price for paid securities was 30,560 KZT, and a month later the price of KZTK in the secondary market exceeded 52,000 KZT and reached a historical maximum, which has not yet been reached by these shares.

Despite the fact that this main part of the placement of Kazakhtelecom's SOS took place outside the exchange market, it was the prototype of the People's IPO series, the first of which took place after Kazakhstan had passed the most acute phase of the global crisis – in 2012.

REPO TRANSACTION MARKET: MOVES AND WINS

The repo market was the fastest growing sector of KASE at the beginning of the 21st century. Since its launch, it significantly transformed the exchange market of Kazakhstan and ensured its competitive advantage over the over-the-counter trade for many years. In just six “fat” years, the youngest of the main sectors of the Exchange turned into an unconditional leader: in 2001 its turnover amounted to KZT 871.6 billion or equivalent to USD 5.9 billion (26.6% of Kazakhstan's GDP), and in 2007 this figure reached KZT 25.7 trillion equivalent to USD 209.8 billion (200%, respectively).

The year 1996 can be considered as a starting point in the history of the repo market of Kazakhstan, when banks began to regularly conduct direct (contractual) transactions with government treasury bills outside the Exchange. After quite a short time, it managed to almost completely replace the market of short-term interbank loans due to the good liquidity of repo items.

The last ones were GS, transactions with which were not taxed. At that time, repo transactions were not declared by the participants when they were registered with the CSD as such, but represented GS sale and purchase transactions. However, the yield of bonds to maturity for the buyer in such transactions and the yield to placement for the seller differed greatly, so that transactions could be identified in the statistics. It was in this hidden form that the repo market came to KASE in 1998 along with the intensified GS trading due to the development of the accumulative pension system.

For the first time, the repo market received official status on the Exchange on July 5, 1999, when the corresponding trade sector opened at KASE. However, in fact, this market started operating on August 2, 1999, when a ban was imposed on conducting direct transactions in the GS sale and purchase sector. As a result, the Kazakh market received two important indicators; they were the true value of "short" money and reliable yield of GS in the secondary market in the sale and purchase sector "cleared" from the effect of repo rates. The government securities were the subject of repo transactions at that time, and all transactions in the open sector were contractual or – as they were called then and now – direct ones.

The key role in the development of the organized Kazakh market of short-term money was played by APFs. In accordance with the laws, pension funds were allowed to conduct only reverse repo transactions, i.e. to lend money on securities. In addition, pension assets received for management could be invested in financial instruments within strictly limited periods. Combined with the falling yields of government securities and corporate bonds, this predetermined the continuous

Repo transactions

The term "repo" is a common abbreviation of the phrase "repurchase agreement". A repo transaction is a combination of two interrelated transactions with securities of the same denomination, with the same persons as parties. Wherein:

- a repo opening transaction is a sale and purchase transaction involving the transfer of money from one of the parties to a repo transaction to the second party and the transfer of a certain amount of securities to the first party to the repo by the second party;
- a repo closing transaction is a sale and purchase transaction with the same securities as in the case of a repo opening transaction, involving the transfer of money from the second party to the repo transaction to the first party and returning the same amount as in the repo opening transaction, the number of securities by the first party to repo transaction to the second party.

In essence, a repo transaction is the crediting of one transaction party by the other on securities. At the same time, the lending rate – the repo rate – consists of the difference between the prices of closing and opening repo transactions and the repo term, which is equal to the number of days between the dates of the opening and closing repo transactions. Typically, the repo rate is expressed as a percentage per annum.

supply of short-term money from APFs in the domestic market, and the volume of this offer was continuously growing. Considering this, banks changed the tactics of supporting their short-term liquidity and reoriented it to the exchange repo market, where they could always buy money at minimum rates, moreover, in the process of open and anonymous trading. The effect of these factors led to the development of the organized component of the repo market of Kazakhstan and mainly the sector of the so-called automatic repo. The rapid growth of the sector's popularity and the continued high demand from market participants for the auto repo sector's instruments for almost 20 years confirmed the timeliness of its opening.

New Leader – Auto Repo

From August 1, 2001, a specialized repo sector was opened at KASE, where government securities of the Ministry of Finance and the National Bank were used as collateral, i.e. the repo item, and trading in money resources was conducted by the main Exchange method – the continuous counter auction. The item of bargaining was repo rates for standard terms, such as 1, 2, 3, 7, 14 and 28 days expressed in percent per annum. It was not GS that were offered for sale and purchase in the trade blotter, but amounts of money divisible by a lot of KZT 5 million. Moreover, the price and quantity of these GS required for participation in the transaction were determined automatically by the KASE trading system. Hence the name of the sector was born – the sector of automatic repo, or shortly auto repo. Since the government securities were the item of repo, the transactions were more accurately called automatic GS repo transactions.

Not specific paper, but their basket served as a repo item. A bidder, who lent money, as a pledge received the number of GS that were adequate in value, but he did not know which GS specifically. However, this was not important, since the investment quality of these securities was similar, the same as the extremely low credit risk of their issuers.

This instrument had another important feature. With direct (contractual) repo, the title to the pledge (i.e. the repo item) was transferred to the bidder, who lent money to the borrower (creditor), upon the opening of the transaction and the bidder could do whatever he wanted with these securities – even sell. In the case of an automatic repo, it was different – the securities were transferred to the creditor's account with CSD and blocked until the repo transaction closing. In the case of successful making of this transaction, the repo item was transferred to the account of the person who repaid the money, and if the debtor failed to return the money, the securities were simply unblocked in the creditor's account. That is, the title to the repo item in an automatic repo transaction was transferred to the lender only in the event of a debtor's default.

According to **Damir Karassayev**, who was the KASE CEO at that time, he "peeped at" the principle of the exchange service in the auto repo sector

during his visit to the Istanbul Stock Exchange: "I realized that we had to quickly implement this with us... Soon we launched these transactions. The most important thing was that we believed that it was launched for corporate bonds; however, in fact, the development went into the repo market for government securities. In principle, repo transactions were not new. The repo market has always existed in Kazakhstan. Essentially, it was formed the day after the release of government securities. Banks have always used the government securities portfolio to regulate their short-term liquidity. As soon as notes of the National Bank, bonds of the Ministry of Finance appeared, banks often used government securities as a pledge to regulate their liquidity. For us, it was important to automate it and transform it into some kind of an exchange commodity. We always understood where the market was, and we always had a desire to participate in it as an exchange... But for a long time I did not understand how this could be organized, and while seeing how it worked on the Istanbul Stock Exchange, we finally came to understanding how to do it."²⁰

With the opening of the automatic government securities repo sector, KASE members started dealing with short-term money on a market basis with absolute informational transparency. Despite the young age of the sector, by the end of 2001, the volume of automatic repo transactions could be compared not only with the volume of direct (contractual) repo transactions, but also with the turnover in the US dollars market. In addition, the National Bank received an effective instrument for regulating short-term liquidity in the open market, which is still actively used. Therefore, it is not surprising that the National Bank contributed to the development of this sector to a large extent.

Since January 11, 2002, Resolution No. 410 of the Management Board of the National Bank of the Republic of Kazakhstan dated October 19, 2001 came into effect to amend Resolution No. 352 of the NSC Directorate *On Conducting Sale and Purchase Transactions involving Pension Assets in Organized Securities Markets* dated June 24, 1999. According to these amendments, reverse repo transactions involving pension assets should have been made only by open trading. This actually meant that all repo opening transactions with PAMC, UAPF or Exchange members authorized by PAMC to make repo transactions at KASE that acted as a securities purchaser should be made only in the KASE automatic repo sector.

This resolution became part of the National Bank's program of transition to the so-called official repo rate (ORR), a key market indicator in the context of inflation targeting, which was chosen as the fundamental principle of market regulation for the following two years. Yes, it was. Inflation targeting was first introduced in Kazakhstan in 2002, not in 2015, as many people believe now. But after the 2008–2009 crisis it was somehow forgotten.

The program of transition to ORR was published on February 20, 2002. At its first stage, the National Bank began weekly announcing an interest rate collar for direct and reverse repo transactions and provided banks with a broad

access to repo transactions at rates within this collar. The main terms of repo transactions with NBRK during the transition period were overnight, seven and fourteen days. However, the National Bank sought to maintain weighted average market rates of repo transactions close to the middle of the above collar. In the case of a dangerous approach to any of its borders, the National Bank, depending on the bias factors, adjusted the liquidity by issuing its notes, attracting deposits, conducting repo transactions or, if necessary, revising the collar limits.

From mid-September 2003, NBRK refused to support the short-term liquidity of STBs in the repo market and limited its intervention to attracting money while sterilizing the market. This strategy continued in 2004. A significant increase in foreign currency earnings in Kazakhstan in the form of export earnings, borrowed funds and foreign direct investment led to the danger of "overheating" of the economy, which forced the National Bank to tighten monetary policy at the end of the year, including by raising discount rates. Although its intention to increase the refinancing rate by the end of 2004 was not implemented, and it remained at the level of 7% per annum, yet NBRK had to abandon the gradual reduction of the single rate for repo transactions (SRR). At the beginning of 2004, this indicative rate was 4.5% per annum +/- 150 basis points. On August 1, SRR reduced to 3.5% per annum (+/- 200 basis points); on October 1 it increased to 4% per annum, and on December 1 it increased to 4.25% per annum.

Thus, the excessive liquidity of the tenge contributed to the steady decline in the price of the "shortest" money. This was particularly observed in October and November 2004, when, under the influence of high oil prices in the world market and a new wave of placement of debt securities of Kazakh companies abroad, huge sums of US dollars were sold in the domestic market. The purchase of a significant part of this currency by NBRK led to an increase in the money supply, as a result of which separate overnight repo transactions were made on KASE at 0.15% per annum. That is, repo rates almost went to zero.

More Securities – Good and Different

Another qualitative step in the development of the KASE money market occurred in 2002, when the Exchange opened a specialized sector of automatic NGS repo. Instruments in the automatic NGS repo sector were grouped by issuers and types of securities in accordance with the new edition of the KASE internal document Automatic Repo Market Specification. It was approved by the Management Board of the Exchange and entered into force on February 28, 2002.

Nothing but shares and corporate bonds listed on the Exchange as A category were used as an NGS repo item, and the issuers fully met the listing requirements. The principal difference of this sector from the sector of auto repo with government securities was that the repo item was always a security of a specific title, rather than a basket of securities.²¹

Trading in the automatic NGS repo sector opened on March 15, 2002 expanded significantly the list of potential repo transactions involving pension assets, and this

expansion was gradual. It is noteworthy that repo rates of return on transactions in this segment primarily depended on the type of shares and corporate bonds and not on the term for money attracted. The bidders, first of all, assessed the degree of market liquidity of NGS used and the investment risks of shares and bonds pledged.

The trend of active involvement of NGS in automatic repo transactions outlined at the end of 2002 actively developed in the following years. If in the first year of existence of the sector transactions were made only with five relevant instruments, their number increased to 45 in 2003 and to 85 in 2004. The volume of relevant transactions increased as well. Such dynamics was associated with the positive experience gained by the market in 2002–2003, the expansion of NGS listed on KASE, and modification of the market valuation methods for NGS used as items of auto repo transactions.

The dynamics of rates of return in the automatic repo sector was quiet. This was explained by the lack of the tenge deficit in the market. The volatility of repo rates significantly decreased, and their dependence on the term of the transactions almost disappeared. Often, overnight repo rates turned out to be higher than the price of longer money, as the cash gaps in banks became shorter, and they only needed the shortest tenge much.

This was confirmed by the dynamics of TONIA (Tenge OverNight Index Average) indicator, which KASE began to calculate as recommended by the National Bank from September 2001 for the rates of automatic overnight GS repo, and which today remains one of the main indicators of the country's financial market. The TONIA behavior generally showed a well-pronounced monthly rhythm, due to the schedule of budget payments, unless the market dictated its own conditions. In some periods, the liquidity of participants in the financial market for tenge and their clients turned out to be so high that the "tax weeks" were worked out by banks without attracting "short" money.

By 2005, overnight repo rates reached their minimum. On the one hand, this was caused by the tightening of the monetary policy of the National Bank, and on the other hand, by very low rates. During this period, money was often placed for a day at 0.001–0.01% per annum.

New Mission of "Direct" Repo

In 2001 – 2006, the sector of the so-called "direct" repo continued to operate on KASE simultaneously with the automatic repo sector, where transactions were made according to preliminary agreement of the parameters of the transaction between its parties. Let us recall that this sector opened on July 5, 1999, but started actually operating on the initiative of brokers in March 2000. Since then, the volume of "direct" repo transactions was growing steadily, reaching USD 15.6 billion in 2007.

Unlike the automatic repo sector, which was regulated by the National Bank through the support of the rate collar, participants in the "direct" repo market were much freer in determining the parameters of their transactions. It was possible to

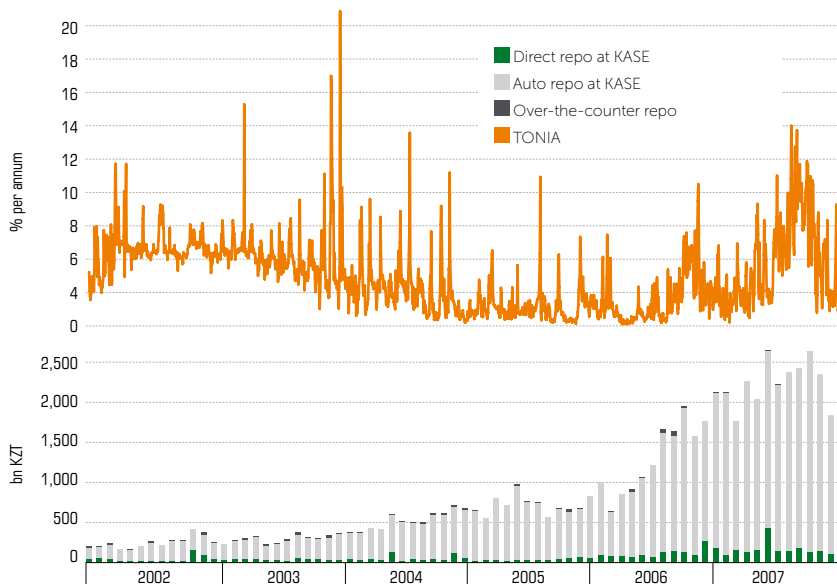
make transactions with any rate of return, with any securities, including government securities, and for any period, although in the first years, as in the automatic repo sector, overnight repo was the most popular.

The structure of turnover in terms of securities used as the item of transactions in the "direct" repo sector was significantly different from that in auto repo. Participants more often used Eurobonds of Kazakhstan; bonds of local executive authorities were involved; NGS share was much higher. The main difference from the automatic repo sector — the limited use of MEAKAM as an item of repo transactions — was due to the minor participation of the National Bank in this sector, which usually dealt with these GS. Moreover, on July 1, 2005, NBRK refused to make direct repo transactions at all, which was officially announced by its Chairman Anvar Saidenov. The reasons for this decision were the lack of securities in the National Bank's portfolio and the low impact of such transactions on the repo rate.

As for NGS transactions, the preference was given to corporate international bonds and bonds on the official list of KASE securities of A category.

A negative feature of the "direct" repo sector in terms of the representativeness of the emerging rates was their not-quite-market nature. The participants (often affiliates) found it beneficial in some cases to deal through direct transactions,

STRUCTURE OF THE REPO MARKET TURNOVER AND WEIGHTED AVERAGE YIELD OF OVERNIGHT REPO (TONIA) IN 2001–2007



solving their financial relationships. For these purposes, the instrument was convenient, especially taking into account the free pricing of repo opening transactions. Theoretically, it could be any price not tied to the price of the repo item in the selling market.

By 2005, the widespread use of NGS as items of “direct” repo transactions was a distinguishing feature. This was explained by the fact that this market was increasingly used by brokers as a source of money, allowing creation of a speculative demand in the stock market. By the beginning of 2006, many members of the Exchange had mastered the technologies of “promotion” of the spot market of particular shares, using the same shares as an item of “direct” repo transactions. To a certain extent, the unparalleled growth of KASE_Shares index in 2006 was associated with the use of such technologies.

In general, we can say that if in 2001–2007 the automatic repo sector was mainly used by participants of the exchange market for traditional purposes, then the “direct” repo sector was used for new and very specific purposes. The dynamics of rates was determined by a variety of factors, including the cost of the repo item in the sector of sale and purchase in the open market and the market of contractual transactions. A new specificity of the “direct” repo market was also manifested in the fact that for the first time the tone was set not by banks, but by broker-dealer companies. For example, in 2005, 49.6% of the gross turnover of transactions accounted for the share of such KASE members.

When Experience Determines the Rules of the Game

The relatively young age of the exchange repo market made KASE very critical about its regulatory framework. Various events arising in the course of trading and settlements became the basis on which the Exchange continued to constantly amend its internal documents. For example, the experience in repo market organization in 1999–2002 was taken into account and summarized in The Rules of Repo Transactions²² and Auto Repo Market Specifications²³ introduced on December 24, 2002 and replacing the previously existing internal KASE documents of similar purpose.

The regulatory framework of the repo market was modernized as the market developed and included the determination of optimal lots for trading, improvement of the market valuation method for securities used as repo item, and strengthening of the responsibility of market participants for scuttling repo closing transactions.

The decision of the KASE Management Board of February 19, 2003 made a new KASE internal document Methodology of Securities Valuation effective on March 25, 2003; this document determined the order of market valuation of shares and bonds used as items of automatic repo transactions and blocking items to ensure performance of bidders’ obligations to the Exchange. The new methodology incorporated the fundamentally revised internal documents of KASE, such as Methodology for Valuation of Government Securities dated April 17, 2001,

and Methodology for Valuation of Corporate Securities dated February 28, 2002. Shares were valued on the basis of the average market maker quotations for their purchases prevailing in the month preceding the valuation date, and the bonds – from the average market maker yield quotations for purchases prevailing during the same period.

From March 12 the same year, KASE started publishing weekly information on the current market valuation of shares and bonds pursuant to the new methodology on the main page of its website. These data could be used by market participants to test their portfolios. In addition, it was assumed that the exchange market valuation methodology for securities would be taken by the National Bank as a basis for market valuation of portfolios of APFs. This intention was implemented by the letter of the National Bank of the Republic of Kazakhstan dated May 28, 2003, where it recommended the APFs and PAIMO to assess their securities portfolios at their market value from June 1, 2003. At the same time, it was recommended to assess GS of the Republic of Kazakhstan and NGS of domestic issuers on a weekly basis.

Struggling with the events of transaction scuttling, on December 30, 2003, the Exchange Council approved the amendments to the Rules of Repo Transactions. The document came into effect on January 1, 2004 and regulated the responsibility of participants in "direct" repo transactions, in case of violation of their obligations to make closing transactions. The innovation obliged the party guilty of scuttling the transaction to pay a penalty in the amount of 5% of the transaction sum to its counterparty. On March 1, 2004, the standard was introduced according to which in case of a scuttling of a "direct" repo transaction with the KASE delisted securities, the party guilty of the transaction cancellation had to pay up to 50% of the amount of the repo closing transaction to the other party. Another important change concerned the possibility of changing the parameters (closing date or closing price) of a repo closing transaction, which was related to a "direct" repo transaction.

The work of KASE on raising the responsibility of participants of the exchange repo market in the performance of their obligations to counterparties resulted in amendments to the Rules of Repo Transactions approved by the Exchange Council on October 20, 2004. The amendments entered into effect on December 22 the same year. They established a ban on repo transactions made by any way, if at the time of opening and closing transactions related, it became known that during the expected repo transaction period, whether full or partial redemption of securities used as the item of the transaction will be made.

Subsequently, the Exchange introduced amendments to the Rules twice. On January 28, 2005, MEUZKAM were delisted from allowed items of repo transactions. On February 1, 2006, it was established that the total number of repo transactions with non-government issue-grade securities included in the official list of KASE A category and used as the item of a repo transaction should not exceed five (regardless of the number of terms specified in statements of KASE members, and the number of such statements), and the maximum repo transaction term for this security could not exceed 90 days.

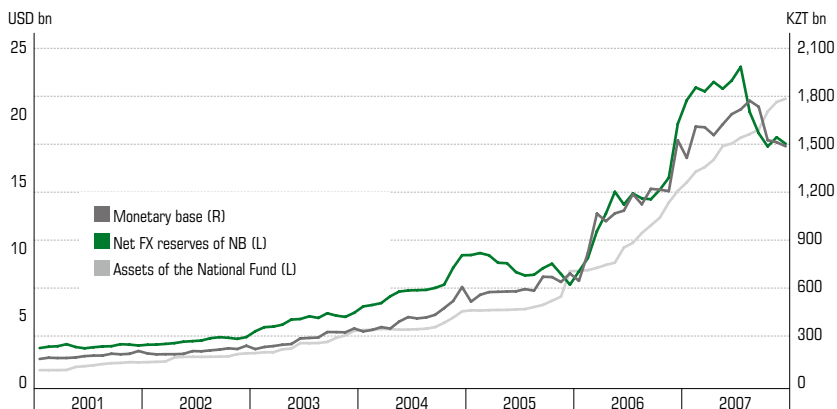
FOREIGN EXCHANGE MARKET: THE MOMENT OF GLORY FOR TENGE

For the currency market of Kazakhstan, the period of ‘fat years’ was marked by the strengthening of the tenge. It did not happen right away. In the first two years, the national currency continued to weaken against the US dollar, although much slower: in 2001 its depreciation against the dollar, judging by the weighted average rate, was 3.8%, and in 2002 the devaluation rate fell to 3.3%. It was not the currency interventions of the National Bank that worked to stabilize the situation in the market, but the actual development of the economy and the import-substituting complex. The speculative potential of the US dollar was removed by monetary regulation methods, which made changes in the exchange rate more predictable and smooth. The USD/KZT chart at the beginning of 2003 was at its highest point – KZT 156 per US dollar, from which a steady drop in quotations started. The tenge began to gain strength.

This was facilitated by the increased inflows of foreign currency to the domestic market, the main sources of which were Kazakh exporters’ receipts (whose revenues grew due to high global prices for energy resources), receipts from privatization of interests in state-owned property (Kazakhmys Corporation JSC and Aktobemunaigas JSC) as well as borrowings of the corporate sector and second-tier banks from foreign markets. As a result, for the first time in its history in 2003, the tenge strengthened in both nominal and real terms (8.03 and 12.4%, respectively).

In 2004, the currency degree of the market increased further, fueled by the same drivers. The price of futures for the supply of Brent crude rose by 29.8% in

MONETARY SYSTEM INDICATORS IN 2001–2007



dollar terms. The trade balance of Kazakhstan increased to USD 7.3 billion for the year (against 4.6 billion for the previous year). Exports increased by 55.8% to USD 20.1 billion. External loans continued to grow. Only through the placement of international bonds in 2004, the Kazakh banks and companies attracted USD 3.4 billion, which was 3.5 times more than a year before. All this led to a significant increase in the volume of foreign exchange operations in Kazakhstan, further strengthening of the tenge against the US dollars, Euro and Russian rubles, and also allowed a significant increase in gold reserves and assets of the National Fund.

However, the joy for the strength of the currency was alloyed by the decline in the competitiveness of the Kazakh goods in its own market. On the one hand, maintaining the predicted inflation rate required minimum intervention from the National Bank in the open foreign exchange market as a buyer of US dollars. On the other hand, the interests of the export-oriented economy demanded a balanced tenge exchange rate against a basket of currencies of the countries that were major trading partners. It was for this very reason that at the end of 2004, when the tenge strengthened against the currencies of Kazakhstan's trading partners in real terms reached critical values, the National Bank of Kazakhstan decided to tighten foreign exchange regulation and began to actively support the market from below.

The most active months, judging by the trading volumes, were the last four months of 2004, when the Kazakh exporters brought foreign exchange earnings accumulated for the summer vacations to the domestic market. The global oil prices that reached their historical maximum in October 2004 led to record high sales of the US dollar at KASE in November and December. The rate of strengthening of the tenge against the US dollar until November 2004 was so high that it allowed Kazakh banks to service their debt in US dollars at negative real rates.

Having received another loan from abroad through the placement of Euronotes or syndication, a bank converted the currency in the domestic market, and when it was necessary to pay interest, bought the necessary amount of substantially depreciated US dollars at KASE and discharged its liabilities. Therefore, the speculative component in the behavior of banking traders in the US dollar market increased significantly in the second half of the year. At the end of 2004, one US dollar cost KZT 130 at KASE, and it strengthened in real terms by 6.1% to the basket of currencies of 24 countries – Kazakhstan's trading partners.

In 2005, the environment of the domestic currency market was largely subject to the measures of the National Bank and FSA aimed at reducing the overheating of the economy and reducing the inflow of US dollars into Kazakhstan, with the exception of foreign direct investment. In addition, the local market responded to the strengthening of the US dollar in the world, geopolitical risks in the region increased, as did the expansion of the capital of Kazakh banks headed by BTA Bank JSC abroad. As a result, the exchange rate of the national currency to the US dollar briefly changed the trend – the tenge devalued in 2005 by 2.91%. But already in 2006, with the forecasts of a general fall in the US dollar in world markets,

the strengthening of the national currency of Kazakhstan resumed. By July 20, the USD/KZT exchange rate reached a record low – on that day only KZT 117 was paid for a US dollar on the Exchange.

In general, in 2001–2007, the nominal tenge strengthening against the US dollar reached 16.5%, against the Russian ruble – 5%, and against the Euro, the tenge weakened by 26.7%.

From the point of view of the financial stability of Kazakhstan, one of the important positive results of the country's economic recovery was the ability to significantly increase international assets. The active participation of the National Bank in the domestic market as a buyer of foreign currency contributed to the replenishment of gold and foreign exchange reserves. Over seven years, their amount increased eight times – from USD 2,318 billion to 17,629 billion, while the assets of the National Fund were increased from USD 660 million to 21,006 million.

On the other hand, the strengthening of the tenge attracted many foreign investors to Kazakhstan, both direct and portfolio ones. It was necessary to “digest” this huge resource by directing financial flows to the real sector and to the economy restructuring. Therefore, the importance of the Exchange as a hub of the financial infrastructure increased.

KASE is a Convenient Currency Hub

The dynamics of development of the foreign currency sector at KASE over seven “fat” years fully corresponded to the general trend of economic expansion and financial market expansion. The annual volume of exchange currency trading between second-tier banks increased from 288.8 billion in 2001 to KZT 1,606.3 billion in 2005, i.e. 5.6 times. By the end of 2006, this figure even tripled, reaching KZT 5,277.3 billion. Although the last record was largely due to a non-system factor. The sharp growth was mainly due to the change in the system of formation of the National Fund in mid-2006 that resulted in “oil dollars” actually converted at KASE twice: first by exporters for crediting to the KZT account of the National Fund, and then by the National Bank when transferring the same money to currency equivalent. In addition, despite the steps taken by NBRK and FSA to tighten reserve requirements for STBs, there was another surge in the volume of external borrowings by banks and the corporate sector. Although in 2007, they could not repeat the 2006 record, the turnover of the currency market again increased more than twice – up to KZT 11,199.2 billion.

The over-the-counter interbank market, where, unlike KASE, the Kazakh banks could make foreign exchange transactions both among themselves and with non-residents, grew at a comparable pace. Its turnover over seven years increased from KZT 1,088 billion to KZT 21,189.0 billion. Excluding transactions with non-residents, an average share of KASE's currency transactions in the total volume of currency transactions was about 55–60%, and it reached 70% by the end of 2007.

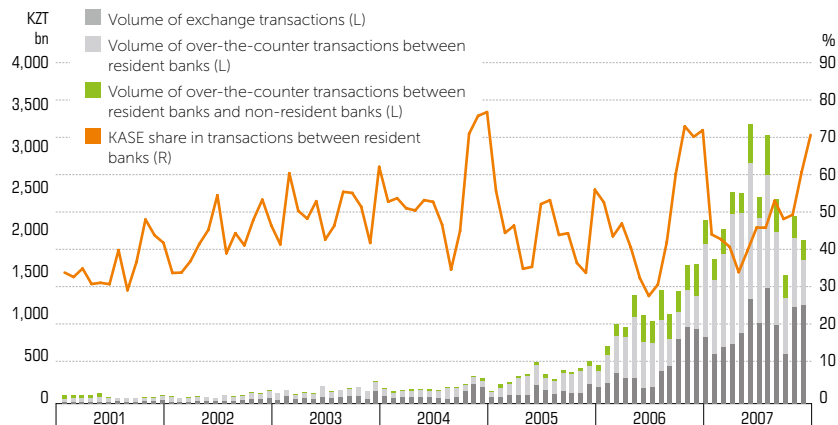
The strong position of the national currency and a fairly stable inflation rate (in 2001–2006, it varied between 4.8% and 10%) contributed to the strengthening

of confidence in the tenge from the public, domestic and foreign investors. At the same time, selling currency at KASE was generally more profitable and more convenient than in the over-the-counter market.

The range of instruments of the currency exchange market included US dollars, Euro, Russian rubles and Deutsche marks. However, trading in DM was ceased on October 1, 2001 due to EUR introduction and DM withdrawal from circulation at the beginning of 2002. The US dollar was a traditional leader in the sector of foreign currencies at KASE – its average share was more than 90% of the total volume of exchange transactions. Without exception, all sessions in foreign currencies were held in the electronic trading system of KASE by open bidding. The Exchange course for the regular TS development and modernization already by 2006 allowed participants of the foreign currency sector to choose different schemes of settlements. It was possible to trade in USD with T+0 (USD_TOD), T+1 (USD_TOM) and T+2 (USD_SPT) settlements, EUR with T+0 (EUR_TOD) and T+1 scheme, and in RUB only with settlements on the date of the transaction (RUB_TOD). Nevertheless, the volume of trading in forward settlements remained small – transactions with the T+1 and T+2 schemes were used by market participants only in the case of holidays, when there was simply no opportunity to make settlements on the same day.

From organizational point of view, operation of the sector was as follows. Three trading sessions in foreign currencies were held at KASE daily: a morning session (10:15 – 11:00 ALT), where the main trading for USD_TOD instrument took place; an afternoon session (11:30 – 15:30 ALT), which was additional for the USD_TOD and main one for EUR_TOD, RUB_TOD instrument, and an evening session (14:00 – 18:00 ALT), which was the main one for USD_TOM, USD_SPT and EUR_TOM instruments.

SECTORAL STRUCTURE OF THE KAZAKHSTAN'S FOREIGN EXCHANGE MARKET IN 2001–2007



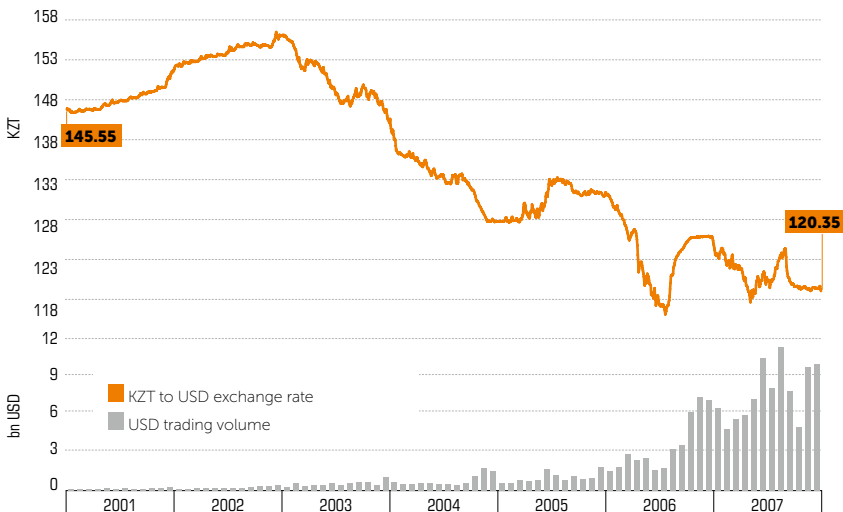
Focus on Liberalization

Today, the exchange arrangement of Kazakhstan does not provide for any restrictions for the free movement of capital. The basis for its liberalization was laid in 2001–2007. At that point, the National Bank had a clear understanding that maintaining restrictions for the export of capital could cause an imbalance in capital flows in the economy and would put pressure on the tenge exchange rate in the direction of its nominal rate, and hence real growth.

In 2002, the Concept of Liberalization of the Exchange Arrangement in the Republic of Kazakhstan was adopted and approved by Resolution No. 369 of the Management Board of the National Bank dated September 11, 2002, providing for the phased abolition of restrictions for conducting currency transactions. On its basis, in 2003, the Program of Liberalization of the Exchange Arrangement for 2003–2004²⁴ was adopted, which was updated in 2004 for the period 2005–2007²⁵.

The implementation of the first stage of liberalization began with the Law adopted on May 8, 2003 *On Amendments to Certain Laws of the Republic of Kazakhstan on Banking, Currency Regulation and Currency Control*²⁶. The main goal of the first stage was to increase the efficiency of the use of foreign currency by expanding the investment opportunities of Kazakhstan's business. In particular, it envisaged a mitigation of the currency regulation control of investment in non-resident securities and direct investment of residents abroad, expanding the

USD EXCHANGE MARKET PERFORMANCES AT KASE IN 2001–2007



production potential of Kazakhstan, which created conditions to penetrate new promising markets and provide the necessary level of control over investment facilities.

At the second and third stages, it was necessary to create conditions for cancellation of restrictions for currency transactions and transition to the principles of full convertibility of the national currency. In this connection, on December 18, 2005, the new Law *On Currency Regulation and Currency Control*²⁷ was enacted. Along with the abolition of a substantial part of currency restrictions, the document established the complete abolition of the authorization procedure for conducting currency transactions and opening accounts with foreign banks and transition to the principles of repatriating currency proceeds within the terms stated by foreign trade contracts from 1 January 2007.

To minimize the risks associated with the liberalization of the capital account and develop timely and adequate responses to potential crisis situations, it was necessary to have a clear idea of the scale and nature of currency transactions and trends in cross-border capital flows. Therefore, one of the important tasks of the second stage of liberalization, which ended in 2006, was to strengthen the system of statistical monitoring of currency transactions. Data on them received by the National Bank under the registration and notification arrangements, as well as within the export-import currency control, created the information base for conducting statistical monitoring and analysis of currency regulation. Very soon, this system was to be tested for effectiveness by the global financial crisis.

KASE AND THE REGIONAL FINANCIAL CENTER (RFCA) PROJECT

On January 7, 2007, the Exchange was assigned an operator of the RFCA special trading platform, which was preceded by extensive preparatory work to establish the financial center in the southern capital city.

The idea of the Head of Kazakhstan to give Almaty the status of a financial center was announced and had been discussed from the mid-1990s. But all the prerequisites, first of all, economic ones, were formed in the new century. Then serious work on the project concept began, with the international consulting company Boston Consulting Group involved. BCG was a government consultant in developing a financial center model acceptable to Kazakhstan. BCG was selected due to the company's experience in the projects for establishment of financial centers in Singapore and Thailand. The Kazakhstan's part in the project was represented by the Center for Marketing and Analytical Studies under the Ministry of Economy.

The developers considered two principal models of the center – international or regional. And it was BCG that gave the recommendation and the rationale in favor of the regional financial center.

On June 5, 2006, the President signed the Law *On the Regional Financial Center of Almaty*, according to which RFCA was vested with a special legal regime governing the relations between the members of the financial center. The Agency of the Republic of Kazakhstan on Regulation of the Activities of the Financial Center (ARA RFCA) was the authorized body of the financial center. The specially established Regional Financial Center of Almaty JSC, abbreviated RFCA JSC, was in charge of the development of the center.

In the course of concept development, a special trading platform was provided within RFCA, which was not an independent stock exchange, but operated (managed and serviced) by a stock exchange operating in Almaty. In accordance with the order of ARA RFCA, KASE was defined as a special trading platform (RFCA STP)²⁸. The members of the financial center – organizations registered with RFCA as legal entities with licenses from FSA for broker and/or dealer activities in the securities market, were the subjects of the financial center.

The securities admitted to circulation on RFCA STP were the objects of RFCA. By law, any disputes between the members of the financial center should have been resolved by a specialized financial court. ARA RFCA fulfilled separate functions of other state authorities in relation to the members of the financial center. The Code On Taxes and Other Mandatory Payments to the Budget provided for a number of special tax benefits for RFCA and its members.

Despite all the contradictions and controversies caused by the project of RFCA establishment in the professional community, some positive aspects of this innovation should be noted.

The RFCA establishment contributed to the improvement of the legislative framework, the formation of the stock market infrastructure, the transition to a qualitatively different level of investment activity of the population after the public offering of Kazakhtelecom JSC at the end of 2006 and the program to improve financial literacy of the population in the regions implemented by RFCA JSC.

OMX Technology AB from Sweden, the operator of the Scandinavian and Baltic stock exchanges, was involved in assessing the market model and technical infrastructure of RFCA STP. Based on the results of an extensive and unbiased technical survey conducted in 2006–2007, it was decided to modify the KASE's trading system. It was about improving the stability and reliability of the system, implementing continuous monitoring of the system performance, providing a variety of services, including through graphical information, providing support for the FIX trading protocol used to connect to the trading system of third-party trading terminals. It was these tasks that determined the further development of the Exchange trading system for the following years.

For the first time in the history of the Kazakhstan securities market, RFCA JSC created a database of the companies, whose securities could be brought to the organized market. There were meetings and explanatory work conducted with these companies. In fact, it was within the framework of the RFCA project that the Exchange started its marketing activities to attract both issuers and

HOW KASE RECEIVED A STATUS OF A COMMERCIAL ORGANIZATION

With the discussions on the operation of the KASE platform as an exchange recognized by RFCA, the question arose of the need to commercialize KASE. On March 29, 2007, in order to determine the ways of interaction between KASE and ARA RFCA, the Exchange Council established the Conciliatory Commission, which held three meetings with the Agency's management, which resulted in the final protocol of May 25, 2007. It contained mutual desires to commercialize KASE, change the principle of voting on the Exchange shares, eliminate restrictions on the purchase of the shares by any stakeholders, and also fixed the intention of RFCA JSC, subordinated to ARA RFCA, to acquire up to 25% of KASE shares in case of public offering (in the amount of up to KZT 600 million), if the additionally issued shares of the Exchange would not be placed in full.

On August 8, 2007, the Law of the Republic of Kazakhstan *On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on the Development of the Regional Financial Center of Almaty* dated July 21, 2007, came into effect, according to which the Law of the Republic of Kazakhstan *On the Securities Market* was changed in the part that determined the legal status and the management system of the stock exchange. Since the Law of the Republic of Kazakhstan *On Joint-Stock Companies* allowed non-profit organizations to operate in the organizational and legal form of a joint-stock company only as provided for by law, on August 8, 2007, KASE de jure became a commercial organization, and its shares became available to an unlimited number of investors.

According to the same law, the principle of voting at the KASE General Meeting of Shareholders was changed from "one shareholder – one vote" to "one share – one vote", and as a counterbalance to

the KASE new management system, a 5% limit was set on the maximum number of shares of the Exchange, which might be owned by a single shareholder together with its affiliates. An exception was made only for RFCA JSC, which could own up to 25% of the total number of voting shares of KASE.

On August 23, 2007, the Annual General Meeting of Shareholders of the Exchange made amendments to its Articles of Association related to commercialization, made a decision to increase the number of announced shares of KASE to 5 million (taking into account the split of existing shares in the ratio of 1:1,000 and the public offering of additionally issued shares) and approved the KASE Development Strategy for 2007–2010, preapproved by the Exchange Council on July 26, 2007. This Strategy was the first official document in the history of KASE, defining the main directions of the Exchange development and the most significant events to be held in these areas.

By the decision of the Exchange Council of August 29, 2007, a workgroup was formed, whose task was to develop the conditions and criteria for a tender to select a financial consultant to place shares of the Exchange in accordance with the Development Strategy for 2007–2010. At the same time, the Exchange Council made a decision to announce the tender on September 10, 2007 to select a financial consultant to place KASE shares. On November 16, 2007, the Exchange announced that according to the tender results, the consortium VISOR Capital JSC (VIZOR Capital) and Centras Securities JSC, which together with KASE proceeded to preparation of the placement of shares of the Exchange, had won the tender.

By the same Law of July 21, 2007, limited liability partnerships with the status of an RFCA member received the right to

apply for membership in KASE in the "basic" categories. In order to protect the basic trading platforms of KASE from small-cap broker dealers, on August 17, 2007, the Exchange Council stated that only the legal entities operating in the organizational and legal form of a joint-stock company could be members of the Exchange. After that, the Exchange proceeded to development of amendments to the KASE internal document The Rules for Arrangement and Operation of a Special Trading Platform of the Regional Financial Center of Almaty, which would allow organizations that

were the members of the Exchange in the "basic" categories and accredited as RFCA members to become a member of KASE in A category, i.e. to become members of KASE as the operator of RFCA STP. These amendments, which became the first step in uniting KASE's trading platforms, were already enacted on January 15, 2008. Further efforts of the Exchange were aimed at ensuring the equality of the sets of financial instruments admitted to circulation on KASE BTP and RFCA STP, and on achieving the state when both platforms would be treated as the same.



The KASE trading floor at 67 Aiteke Bi, 2007

investors to its platform. Much later, after the crisis, in 2016, KASE resumed these activities at a fundamentally new level, focusing on the regions, and continues to this day.

Based on RFCA, the first national rating agency in Kazakhstan was established to provide the services for independent assessment of local companies with assignment of corporate credit ratings and corporate governance ratings. For the first time, an attempt was made to create our own rating system for domestic issuers and investors. The Malaysian Rating Agency was the strategic partner of RFCA RA.

Another project implemented by RFCA together with the Russian RTS Stock Exchange using its advanced technologies was the establishment of the Eurasian Trading System (ETS) commodity exchange in Almaty. Today it is one of the largest commodity exchanges in Kazakhstan, where agricultural products are mainly traded, such as wheat, rye, barley, sunflower seeds, flour and sunflower oil. A clearing center, technical base and risk management system were created in order to implement effective futures trading on this exchange to guarantee the transactions of market actors.

Nevertheless, RFCA did not fulfill all of its functions envisaged upon establishment. It was not a right time for it: in 2007–2008, the financial crisis started unfolding in the global economy, which hit both the real sector of the economy and all segments of the financial sector of Kazakhstan. The securities market was also affected; the outflow of investors began; the volumes of exchange trades reduced. The operation of two trading platforms – RFCA STP and KASE BTP – under such conditions was unreasonable.

On the other hand, their merger resulted in a single platform with simplified listing requirements, which made it possible to attract small-cap companies, the so-called second-tier companies, to the stock market as issuers. This project, which was initiated mainly by RFCA JSC, turned out to be quite risky, since later, in 2009, the majority of such companies defaulted. Nevertheless, the processing of these defaults, including in the form of establishment of a “buffer category” of the KASE official list, provided the Exchange with valuable experience, which was taken into account almost ten years later when creating an alternative platform on the Exchange.



2nd Annual Financial Market Conference of the Kazakhstan Stock Exchange, 2008



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Chapter 4
**A CRISIS
CHALLENGE**

FORERUNNERS OF THE FIRST WAVE

ALL-OUT ATTACK

THROUGH DEVALUATION AND DEFAULTS
TO RECOVERY AND GROWTH

Chapter 4.

A CRISIS CHALLENGE

In early 2007, by the inertia of the “fat years,” everything was going on, or more precisely, was perceived as a continuation of the period of well-being. But as the saying goes, the storm was gathering. The professional community understood: a crisis was inevitable. The occurrence of the crisis was only a matter of time. But since Kazakhstan’s economy reacted to global events with a time lag, there was still an opportunity to cover the bases as much as possible.

The Financial Supervision Agency officially confirmed its concern about increased risks in the financial industry, particularly in the banking sector during the first news conference held in January 2007. The then FSA¹ head, Arman Dunaev², announced regulator’s intention to react very strongly to the situation and to develop preventive strategy.

According to the FSA, the total amount of all liabilities of the banking sector before non-residents almost doubled in 2006. As at the beginning of the year, their liabilities amounted to KZT4,125.1 billion and the share in the total volume of liabilities of the second-tier banks amounted to 51.6%. The FSA management noted that the share of the total external short-term liabilities of banks reduced almost two-fold after the requirements to attracting foreign borrowings were strengthened. The agency also took care of strengthening control over retail lending.

FORERUNNERS OF THE FIRST WAVE

At the start of the year, the country’s international reserves grew – in January, the FX reserves amounted to USD 35,639.4 mln (+7.4%). Banks continued road shows along European capital cities and financial centers, collecting long money. In early February, Alliance Bank³ proudly announced the successful placement of the debut Eurobond issue for 750 mln EUR⁴; more than 235 investors took part in this transaction. Previously, it was reported that “the net profit of the bank reached 14 bn KZT”.

Meanwhile, the domestic situation with Valut-Transit Bank was rapidly developing. On February 14, 2007, the media reported the forced liquidation of the bank based on the claim initiated by FSA in connection with the revocation of the bank’s license⁵. The bank owed its customers 21 bn KZT. But, as the Kazakhstan Deposit Insurance Fund⁶ reported later, the amount of guaranteed payments to individuals from Valut-Transit Bank would be about 16 bn KZT.

On January 7, the order of the Chairperson of the Agency of the Republic of Kazakhstan on Regulation of the Activities of RFCA⁷, defining KASE as the operator of

a special trading platform (STP) of the center, entered into force. And ARA RFCA itself intensified activities in the regions and signed memoranda of cooperation. The rules for STP arrangement and operation were agreed: they identified the members of the Exchange that could perform transactions at the Exchange; conditions of participation in trading; types of securities; procedure for admission of securities to circulation; listing and delisting procedures. On February 27, the first trading at RFCA STP took place.

In March, the management of KazMunayGas EP went on the European road show to present its consolidated financial statements for the past year.

In April, ING Bank, Standard Chartered Bank and Sumitomo Mitsui Banking Corporation Europe Limited granted a syndicated loan in yen to the BTA group, equivalent to USD 500 million⁸. In May, EBRD joined the shareholders of SAPF pension fund by buying out 9.99% of the total number of shares⁹...

In such a mosaic, but rather positive way, interspersed with some negative aspects, the situation in the financial sector looked in 2007. Nevertheless, experts, and in particular, Standard & Poor's analyst *Yekaterina Trofimova*, told to The Expert magazine back in March about low capitalization rate of the Kazakh banks, which made them exposed to unfavorable movements in the market.

"Capital is a kind of a safety cushion, and the thinner and poorer it is in quality, the higher the threat of a fatal outcome. New restrictions on foreign borrowings introduced in Kazakhstan this spring are designed to encourage an increase in bank capital, but we do not expect any fundamental improvement in capitalization rates in the near future."

*In response to external and internal alarms, NBRK and FSA started preparing annual statements on financial stability from 2006. The Chairperson of the National Bank *Anvar Saidenov* commented on the situation: "Our task is to identify the alarms, because their transition to critical means that the market is in a pre-crisis situation. An alarm, which has been flashing for several years, is the volume of gross external debt and its ratio to GDP. As of June 30, the external debt was USD 91 bn and was close to GDP. Almost half of it – 45.4 bn – is external debt of all second-tier banks. In the third quarter, the second-tier banks should repay a bit more than USD 3 bn. And almost the same amount in the fourth quarter."¹⁰ Therefore, FSA and the National Bank took a number of measures that provided the banks with certain "compensatory opportunities."*

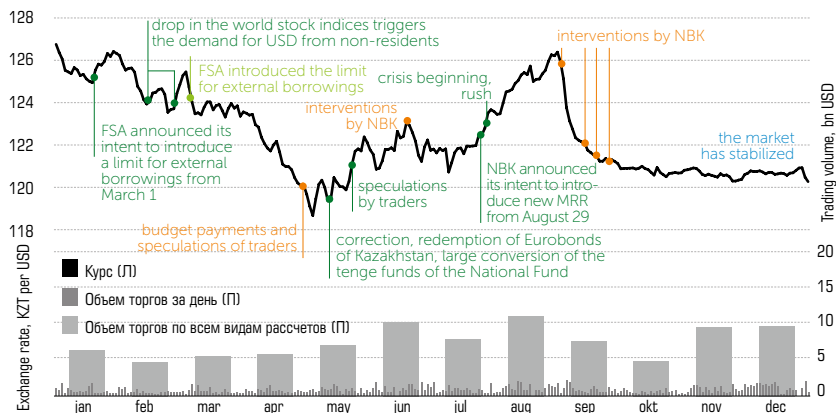
But on the last summer weekend there was a feverish demand for US dollars. It resulted from those alarming signals of the crisis that came to Kazakhstan from abroad. According to Anvar Saidenov's memories of those days, fortunately, in that situation they didn't have to use the National Fund, but the National Bank's FX reserves decreased from USD 23 to 17 bn in the peak of the crisis events. The National Bank sold USD 4.5 bn in the market late in August and USD 1.6 bn more in September 2007. This was done in order to calm down the market, keep the

exchange rate stable. As a result of the measures taken by NBRK, the national currency strengthened quickly – from KZT 126 to 121 per US dollar.

Experts considered that one of the reasons for the drastic changes in the exchange rate was not only the panic of ordinary people triggered by the reports of the crisis, but also the withdrawal of foreign capital by foreign investors from Kazakhstan. They would withdraw short-term tenge deposits and exported currency while leaving the country. According to the estimates of the National Bank, the “flash capital” amounted to USD 4–5 bn. One of the measures taken by NBRK at that time was a noticeable tightening of the lending policy of the banks starting from the second half of 2007. The measures of the National Bank included, but not limited to: the liquidity provision (repo); revision of the mechanism for the formation of minimum reserve requirements (MRR) – the changes were aimed at reducing the base of reserve liabilities and expanding the structure of reserve assets. This allowed STBs to additionally release about KZT 150 bn.

All these events were intertwined with the workflow of the Exchange. In the introduction to the 2007 KASE Report, **Azamat Dzholdasbekov** wrote: “Well, here it is. The Global Financial Crisis. Seven “fat” years ended upon its occurrence. This time, in contrast to the 1997–1998 crisis, the new crisis did not pass by the financial market of Kazakhstan. It means that the market has matured and fit into the global financial system, which is generally not bad. On the other hand, the market has turned out to be unsettled so far: in theory, even in case of perturbations, the trade turnover should exist. In Kazakhstan, it fell due to the “escape” of non-professional investors, who were deterred by price failures. In addition, the share of pension assets in relation to which

KEY EVENTS THAT AFFECTED THE USD EXCHANGE RATE DYNAMICS IN 2007



THE GLOBAL FINANCIAL CRISIS OF 2007–2009

Kazakhstan overcame the first shock and, as it turned out later, the first sign of the global financial crisis. Similar signs could be noticed everywhere – in Europe, in Asia, and in the USA. For example, in Europe, Northern Rock – the UK largest bank – was the first victim in September 2007.

It is now believed that the crisis of high-risk subprime mortgage loans in the United States served as the trigger, which initiated the hidden risks in the financial systems of many countries. The volume of overdue payments on mortgage loans kept on growing, the banks started alienating pledged real estate; opportunities for refinancing of such loans were narrowed down, the prices for securities backed by subprime mortgages began falling.

September 15, 2008 is considered the starting point of the global financial crisis. It was the day when one of the US backbone banks Lehman Brothers announced bankrupt. The world markets reacted to this event with a drop in prices: Dow Jones Industrial Average dropped by 504.48 points (4.42 %); S&P 500 by 59 points (4.71 %); NASDAQ by 81.36 points (3.6 %); MICEX lost up to 10 %. Following Lehman Brothers, American International Group insurance holding lost its balance. In September, Merrill Lynch investment bank was sold. It was

purchased by the Bank of America. At the same time, US investment banks, such as Morgan Stanley and Goldman Sachs were transferred to FRS for regulation.

In this situation, investors were rethinking their positions in relation to developing countries. The liquidity crisis in the global market led to a tightening of the lending terms for emerging market entities, including Kazakh banks. Anvar Saidenov, the Chairperson of the National Bank believed back in August 2008 that it was almost impossible to avoid any influence on the domestic economy of Kazakhstan due to the high degree of integration of the economy into the global one. The Kazakh banks also responded to the changing situation: the growth rate of mortgage lending by second-tier banks fell from 27 % to 3.4 % in the first half of 2008.

In general, experts identify three phases of the global crisis: the first phase was from August 10, 2007 to September 15, 2008; the second phase from September 15, 2008 to April 1–2, 2009 (it is generally assumed that the reorientation of the global economy and the trend reversal began with the G-20 London Summit); and the third phase after April 1–2, 2009¹¹. However, many analysts agree that it has moved to a latent state and is still lasting.

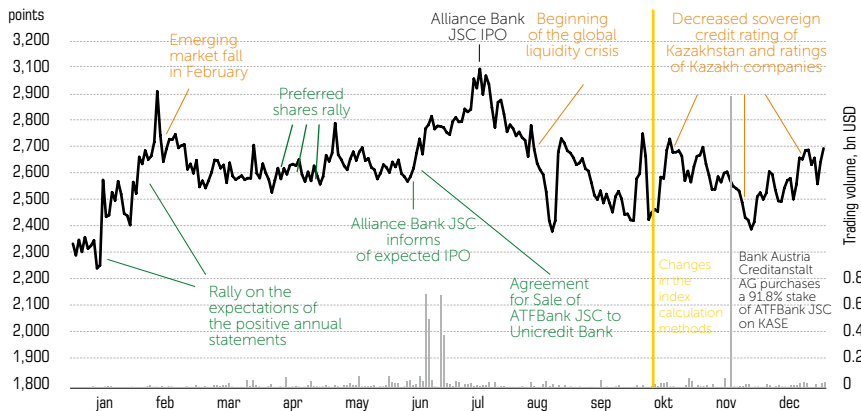
the government has changed investment guidelines has sharply reduced in the market. So there are pros and cons. There are ups and downs. There is something called "life": KASE also lives its own life, which does not stop even because of the financial crisis."

The Exchange switched to the operation under conditions of financial instability. The foreign exchange market, which was still US dollar-dominated, was severely tried. Conventional factors formed the market conditions until the end of the first ten days of May. But other events had already got intertwined into the familiar context: the collapse of the world stock indices in February 2007, the escape of non-residents, the introduction of FSA restraints on external borrowings. In addition to the events mentioned by the Chairperson of the National Bank.

Starting from the second ten days of May 2007, the market traditionally began to work out a correction, throwing off the excessive "oversale" of US dollars, which occurred in the period of budget payments in 2006. But the correction went so far that it resembled a global market reversal that resulted in making the National Bank to have a damping effect on the market in mid-June.

The August rush was described in the KASE report: "Individuals and legal entities would withdraw deposits from bank accounts in an effort to convert the money received into US dollars or euros. The situation was aggravated by the growth of money market rates and a severe reduction in banking lending programs. By the end of August, the situation had gone so far that the National Bank was forced to make big currency interventions at KASE that resulted in returning KZT/USD exchange rate to the pre-crisis values. From mid-October until the end of 2007, the Kazakh US

KEY EVENTS THAT AFFECTED THE KASE STOCK MARKET INDEX DYNAMICS IN 2007



dollars market looked quite well-balanced and stable in terms of prices. The market actors believed in the effectiveness of crisis measures taken by the government and the National Bank, and in the futility of attempts to destabilize the course." It means that the regulatory levers worked that time.

There were also changes in the stock market. By summer, the growth of KASE_Shares Index, which began in mid-2005, stopped, and the capitalization of the exchange stock market, depending in 2007 mainly on the prices for equity instruments, rather than on changes in the Exchange lists, reaching a maximum value of USD 70 bn in July, started falling. Foreign investors, who were concerned about the great dependence of the Kazakh banks on foreign financing as well as the quality of their assets, started closing long positions in the securities of Kazakhstan, causing a collapse in the prices of shares and bonds of domestic banks abroad and in Kazakhstan. The fall of the market was prevented by the enthusiasm of investors, who would buy up the depreciating stocks. Of course, they failed to reverse the global trend of "escape for quality", but their actions stabilized the Kazakhstan's market significantly.

Panic and gradual deterioration of the economic situation led to the fact that the stock market had almost lost the potential for further growth, although there was still no drastic fall. The market capitalization rate at KASE decreased by 4.91% in 2007 and the growth of the stock market indices (first the KASE_Shares Index, and then the KASE index) did not exceed 9.1%. Share rates of almost all Kazakh banks fell, and mining companies became a "refuge" for investors.

The strong position of the preferred shares was typical of that year. At the end of the year, an average increase in the value of such "prefs" exceeded 58%, and the annual turnover increased 3.5 times and amounted to 19.3% of the total turnover of the stock market.

The corporate bond market backed down from the blows of the global crisis, as well. In August 2007, the minimum volume of exchange transactions was recorded. And although it intensified in September, the transactions were made with a distinct fall in prices and an increase in yield.

KASE_Shares Index and KASE Index

On October 1, 2007, KASE launched a new index of its stock market – KASE Index. This was due to the movement of the stock market to an absolutely new level of development. As it was noted in the release of the Exchange, "KASE Index is designed to reflect the situation in the domestic organized stock market in a more adequate way than KASE_Shares, and according to the Exchange, this will give impetus to the establishment of index funds and, perhaps, the market of the relevant derivatives." The fundamental difference between KASE Index and KASE_Shares Index was that the new index was calculated based on transaction prices, and the old one allowed calculation based on the quotes of demand and supply without transactions. In other words, the liquidity level of the KASE stock market in 2007 was sufficient to start calculating the index in accordance with the internationally accepted standards. The values of the KASE Index continued the time series of the KASE_Shares Index.

Stabilization at the average monthly scores was outlined at the end of the year. At the same time, the primary market, where the banks, which that had lost the opportunity to refinance abroad, tried to borrow money from local investors, intensified noticeably. However, the current inflation rate did not allow it to be done at an affordable price. As a result, only the bank affiliates, with which the second-tier banks had to share risks, bought the proposed bonds. This was the main reason why the share of APFs of Kazakhstan in the stock market began to grow by the end of the year.

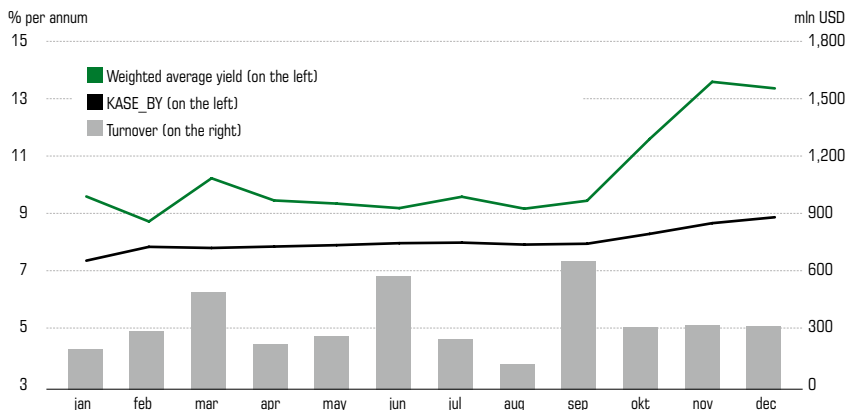
In the fourth quarter of 2007, the Ministry of Finance became more active and acted as a serious competitor of corporate bonds. If at the beginning of the year, this agency placed at a convenient rate and was not interested in attracting money, in the second half of the year it was motivated by the need to finance the budget deficit that had appeared.

MF preferred to issue inflation-indexed bonds and discount MEKKAM, i.e., the most attractive instruments for private pension funds. And investors bought these GS most willingly. The rates on medium- and long-term bonds of the Ministry of Finance in the primary market shot up by 300–400 basis points by the end of 2007. By the end of 2007, the secondary GS market had practically stopped operating due to the crisis.

The National Bank had the opposite motivation. If in the first half of 2007, NBRK sterilized the market due to the issuance of notes, then after the August events, it was more concerned about maintaining liquidity in the financial system. The National Bank began to redeem bonds before the maturity. As a result, the volume of notes in circulation decreased from 7 billion in August to USD 2 billion in December.

The repo market fully experienced the “clash” of crisis and anti-crisis. As a result of the two opposing trends, the repo market at KASE slowed down significantly, and

EXCHANGE TURNOVER AND CORPORATE BOND YIELD DYNAMICS AT KASE IN 2007



the price of “longer” money continued to grow, demonstrating the escalation of the impact of the global liquidity crisis on the economy of Kazakhstan.

In 2007, the repo market had 65.1% of KASE’s total turnover. As before, this market was, on the one hand, a source of short-term liquidity for the Exchange members, on the other hand, a platform to place temporarily redundant cash, and on the third hand, a place through which NBRK could effectively influence the market with monetary policy instruments.

Several more events that had an impact on the exchange market should be mentioned.

On January 1, the Tax Code was amended so that the tax incentives, which applied to the gains from GS sales, changed. The amendments were strongly promoted by KASE through the Association of Financiers of Kazakhstan¹². The change in the tax regime had a direct effect on the stock exchange market of the country, where the “market” transactions made in open trading finally began to prevail in 2007. Prior to this, KASE had been struggling with a high share of direct (contractual) transactions for several years, trying to encourage the parties to arrange market pricing.

On March 1, the Exchange abandoned the method of Frankfurt trading when trading in the most popular listed shares, since their liquidity made it harder to make contractual transactions that looked like market ones.

On December 23, 2006, the Rules for Investment Management of Pension Assets¹³ were put into effect, and on December 15 the Guidelines on the Regulatory Values of Prudential Standards, Calculation Methods for Organizations Engaged in the Investment Management of Pension Assets¹⁴ became effective. These regulatory legal acts replaced the previously existing ones and de facto created a new system of investing pension assets, which served as the main driver of the national stock market for seven years and was the root cause of Kazakhstan’s “bond boom”.

If previously the local non-governmental securities listed in KASE’s official A category meant that the issuers of such securities had access to pension assets, then in the new system, the only actual investment criterion for PA managers was that the securities or their issuers had rating scores. This resulted in a rapid decline in the interest of the Kazakh companies, especially those focused on attracting resources of accumulative pension funds, in listing their securities at KASE.

It is noteworthy that FSA did not set any transitional period for a paradigm shift in the investment behavior of pension assets managers: as of January 1, 2007, the actual amount of pension assets invested in securities with the appropriate rating scores (including shares, whose issuers had appropriate rating scores) should have been at least 30% of the total pension assets of each APF. And by July 1, 2008, this portion was required to be gradually increased to 70%.

Artificial apathy of pension assets managers towards securities listed on KASE affected not only the number of new listed companies: the share of gross turnover of the KASE secondary stock market falling on investments from pension assets decreased from 11.8% in 2006 to 5.4% in 2007 (2.2 times). The value of the corresponding indicator in the secondary corporate bond market also decreased by 2.2 times – from 25.9% to 11.6%.

Time showed that 2007 was only a foreboding of a crisis. The crisis itself occurred and expanded to the full extent in 2008. And it took its time for the following two years.

ALL-OUT ATTACK

*KASE approached its fifteenth anniversary and prepared for trials. **Anvar Saidenov**, the Chairperson of the National Bank of Kazakhstan, said in his interview to *Kazakhstanskaya Pravda* in January, "The 2008 year will most likely to be a challenging year. The National Bank considered two scenarios for the development of Kazakhstan's economy: basic and pessimistic. The third one – an optimistic scenario – was not considered. First, the probability of occurrence of such scenario is quite low... The National Bank understands that in case of a drastic aggravation of the situation in the global financial market, some emergency measures will have to be taken to support the domestic banking system."*

At the beginning of the year, according to preliminary estimates of NBRK, the total external debt of banks amounted to about USD 46 bn. And banks continued getting refinance in international capital markets. This means they borrowed to cover the old debts. In 2008, it was more important for them to find resources at any cost, even if it was more expensive than reducing the debts.

In January, the National Bank presented the Key Monetary Policy Guidelines for 2008–2009. The main goal of the monetary policy was to keep the annual inflation rate in the range of 7.9–9.9% in 2008 (it actually was 9.48%), and 7.5–9.5% in 2009 with any of the scenarios – whether basic or pessimistic. The document focused on a set of measures to ensure the stability of the banking system.

*Also, since the unfolding of the global crisis, FSA's role has visibly increased. "The Government, the National Bank, the Financial Supervision Agency should establish effective mechanisms for rapid and consistent response of the government to the threat to the financial instability and to enhance confidence of international markets in the economy of Kazakhstan", **President of Kazakhstan Nursultan Nazarbaev** said in the state-of-the-nation address to the people on February 6, 2008. "The work of the Financial Supervision Agency must be strengthened on ongoing basis. The main task of the Agency should be the improvement of competitiveness and sustainability of the country's financial system, particularly of the banking sector in cooperation with the National Bank and the Ministry of Finance. The life will make adjustments to our plans. We must be prepared. We must learn lessons of the subprime mortgage crisis in the U.S., which had a significant impact on our banks. The FSA must monitor the situation in each bank more closely and, if necessary, take preventive and*

*effective measures. Government support cannot be one-sided and banks should assume their part of risks. If shareholders of banks are unwilling or unable to attract additional resources for their development, the government must be prepared to take necessary measures. The process of regulatory intervention should be absolutely transparent and predictable for the entire banking sector.*¹⁵

In February 2008, Elena Bakhmutova,¹⁶ speaking for the first time as the FSA chairman from a rostrum of Fitch Ratings's conference "Kazakhstan in the conditions of global liquidity crisis: risks and ways of confrontation", quite clearly and toughly indicated paths of the relationship and the new rules of the game: the market will be tightened and controlled. Especially over the units responsible for risk management system.

*"Our focus on strong regulation will be continued and our top priority will be inspection and assessment of risk management systems of financial institutions," Elena Bakhmutova said. "A technical committee that will work on supervisory procedures for rapid response will be established within FSA"*¹⁷. *The problem issues of the banking sector were as follows: high rate of loans provided to non-residents (15.9%), decreased share of standard loans from 52.6% to 39.8% over the year (from January 1, 2007); the rise in the share of bad loans from 45.8% to 58.7%.*

But we were not alone in meditating. Quite literally, almost the entire planet felt down from the beginning of the year. Long before the February Davos, the meeting of the leaders of the world financial elite was called the "forum of pessimists."

According to the findings of Gallup International, which conducted research ordered by WEF in 60 countries, when asked about the economic future of the world, 54% of the Western Europeans and 43% of the Americans believed that the next generation would exist in worse economic conditions. However, 71% of the Africans expected economic prosperity at that time, apparently believing that it could not get worse. People in the post-Soviet countries were also quite optimistic, most likely due to the fact that they were still new to the market economy.

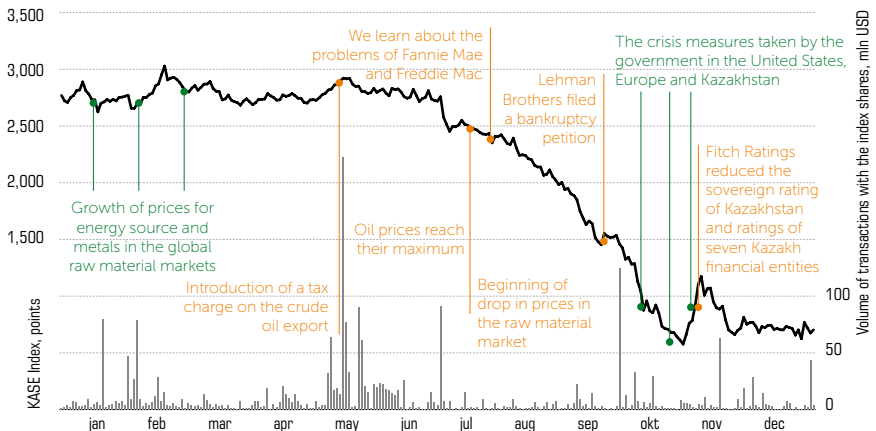
A week later, almost nobody recalled the Davos Forum, which had provided no unified recipes to fight the recession – the events, mostly negative, changed rapidly. In early September, the largest nationalization in the history of the country was announced in the United States: the Treasury Department and the Federal Reserve System sent USD 188 bn to the federal mortgage agencies Fannie Mae and Freddie Mac. The shares of both agencies in the stock market collapsed – their quotes fell by 75–80%. In the middle of the same month, Lehman Brothers, a US investment bank, filed a bankruptcy petition. A global depression started, followed by the second wave of the global financial crisis. The recent Davos Forum left an actual slogan of 2008 – a piece of advice given by Sam Walton, the founder of Wal-Mart, the largest international network: "Control your expenses better than your competition. If everybody is doing it one way, there's a good chance you can find your niche by going exactly in the opposite direction."

For the year in the United States alone, 25 banks went bankrupt. It was not a surprise that at the end of the year, President George W. Bush stated that he felt responsible for the economic recession and apologized. But it was hardly anything compared with the bankruptcy of 140 US banks in 2009 and 157 in 2010¹⁸. And if before Kazakhstan was in a quiet, almost local bay, then the country had to experience the power of the whole ocean and face the negative effect of all the consequences happening in the world.

In April 2008, the regulator presented conceptual ideas of the Agency's new strategy on rapid response to negative trends in the financial market with a large component of preventive measures. The draft of this document had been discussed with market participants and at the FSA Technical Committee.

"Maybe those response measures that we are taking do not seem relevant to the current moment, but they stipulate those framework and trends that are likely to be present in the long term," Elena Bakhmutova, the FSA head, said. "We are introducing early response system so that we do not wait until certain event takes place but prepare for its probable occurrence". The system that is being established should include balanced approach between development and risk. This is the key message of the work we do today. We are talking about balance between motivation of shareholders, management bodies of banks and financial institutions and the liability for decisions taken. But the FSA's actions should also be clear, predictable and transparent. Therefore, all these regulatory measures were announced in advance, they were discussed with market participants so that banks could adjust to them."

KASE SHARES INDEX DYNAMICS IN 2008



The system of response and regulation was built to suit all financial institutions that fall under the FSA's supervision. First and foremost, constant monitoring of general macroeconomic indicators not only those of the financial sector taking into account their mutual influence. Response measures depend on the situation. The first stage stipulates recommendations, dialogue (not sanctions!) with financial institutions and performance of actions prescribed by the regulator. The sanctions are imposed at the second stage. Interventions are made and sanctions are imposed if the standards have been violated.

The most crucial for the country's economy comprehensive solution was announced by the head of state Nursultan Nazarbayev on October 13, 2008. Speaking at the Government meeting, the President instructed to allocate USD 10 billion from the National Fund to overcome problems caused by the global financial crisis¹⁹. Three key areas were identified: ensuring macroeconomic stability, social well-being of the Kazakh people and modernization of the economy. The Government was given carte blanche for stabilization of the economy and the financial system.

Describing the 2008 trends, KASE analysts identified two periods divided by a turning point. In the first half of the year, the environment of the Kazakhstan Stock Exchange, as well as the entire financial market, was driven by optimism caused by the unparalleled growth of global commodity markets. In the second half – by the negative economic news coming from Europe and the United States. In the first period, there was an overflow of capital from financial markets into commodity markets. This allowed the country to improve the situation with the country's balance of payments, and the banks to obtain additional liquidity without making money market transactions. As a result, the need for repo transactions decreased, the volume of exchange trades and rates in this market segment reached annual minima in May, and the volume of trades in the foreign currency market continued growing.

In the first half of the year, the mineral companies of Kazakhstan reported super profits, and the Kazakh banks seemed to be coping with a liquidity deficit. The stock market stabilized. All this, to some extent, won back optimism to the local market, but in July 2008 the price "bubble" in the overheated global commodity market burst. And along with it, everything that inspired optimism to us also burst. Kazakhstan's export flagships could only watch the prices for their goods falling down. For example, Brent crude oil fell from USD 145 in July to USD 35 per barrel in late December.

"Of course, the global financial crisis of 2007–2008 was among the events that I remember due to its effects on the Kazakh market. This shook the global economy so much that to this day investors and other market actors fear similar bursts." Yeszhan Birtanov²⁰, Managing Director of Baiterek NMH, who worked for the National Bank in those years, recalls. "The most atypical for us were the days of the US mortgage crisis. I worked as a deputy director of the Monetary Transactions Department at that time, supervised the management of the investment portfolios of the National Bank and the

National Fund in international markets. The portfolio contained US dollars, euros, pounds, yen and other currencies. The stock portfolios under internal management had Lehman Brothers shares, but in anticipation of the crisis, we liquidated all positions on shares of US and European financial companies in 2006. The positions on corporate bonds of financial companies were liquidated in advance. The positions on mortgage backed securities (MBS) were also liquidated. Thus, we managed to avoid large losses. This step was the result of our careful efforts in the market and networking. We cooperated with large banks, collected information from various partners all the time – from American, Japanese and other banks. As for mortgage bonds, for example, I remember that Japanese investors were really worried. In terms of shares, we just tried to close all positions on bank shares in the portfolio rather than trying to guess the risks for a particular bank, because bad rumors spread quickly, and we had to act proactively. As a result, we avoided serious problems. Although, the truth is that there were losses, of course. Part of these portfolios were managed by external managers, we insisted and recommended that they closed the positions in the respective markets.”

The severe strain of liquidity in Western countries along with the panic of investors resulted in mass sales of assets of emerging markets as the most risky ones. The prices for shares and depositary receipts of Kazakhstan’s companies abroad began to drop, and arbitration led to an equivalent fall in prices in Kazakhstan’s stock exchange market.

The situation got worse on August 2, when Doszhan Temir Zholy JSC – the issuer of the first infrastructure bonds in Kazakhstan – defaulted on the payment of the next coupon interest on the bonds. In anticipation of new defaults, which were easily predicted against the background of rapidly growing intercorporate debt, investors were in a hurry to sell off the bonds of Kazakh issuers and left for less risky financial instruments. Affected by this process, the yield of corporate bonds flew up rapidly in August. The end points of the “escape for quality” were mainly bonds of the Ministry of Finance of Kazakhstan, and sometimes US treasury bonds.

The country’s pension system also was at risk. In October 2008, the Financial Supervision Agency confirmed that net investment income of private pension funds has reduced as at the first day (October 1, 2008) compared to July of the current year. Investment income decreased from KZT 386 billion to KZT 339 billion over this period, which is by one billion less than even as at the beginning of the year. Commenting on the situation at a press conference, Alina Aldambergen, Deputy Chairman of FSA, noted that the downtrend was due to such reasons as “lowering prices of securities of Kazakh and foreign issuers that are traded on the Kazakhstani and foreign stock exchanges and lowered value of shares of issuers present in KASE Index, which has reduced by 26% this September.”²¹

Among them were the securities of such issuers as Gazprom, Sberbank of Russia, LUKOIL, JP Morgan and Alliance Bank traded at the Kazakhstan and foreign stock exchanges.

A downward change in KASE Index in September 2008 was mainly because to the value of shares of the following companies that are included in the Exchange's Index: shares of KAZAKHMYS PLC fell by 52%, stocks of KazMunaiGas Exploration Production decreased by 30%, shares of Khalyk Savings Bank of Kazakhstan, whose depository receipts are traded on the London Stock Exchange, were down 31%.

Considering that most securities held in portfolios of private pension funds are the most liquid financial instruments, although undervalued ones, Alina Aldambergen noted that "in the event of a continuing fall in the yield of private pension funds, they will have to compensate for the losses of their depositors at their own expense in accordance with the legislation. The FSA toughens the requirements to them including capital adequacy requirement".

A very important circumstance was the drastic drop of the value of shares and bonds used as items of repo transactions at KASE. The market value of investment portfolios, which were created at the expense of borrowed funds of the repo market, turned out to be significantly lower than the nominal value of liabilities on them. Such portfolios proved to be loss-making, and their creators were insolvent. Hoping to adjust prices, some of them used continuous extension of expiring repo transactions or refinancing of the pyramid thus created with even more risky loans. A sharp increase in repo rates in the fall and a series of defaults in the repo market in December 2008 were the natural result; the measures to settle that had to be taken by KASE and FSA as early as the following year.

In view of the above, the government securities market was the most predictable and stable Exchange sector in 2008. The decrease in the issuing activity of the National Bank in the sector of its notes was offset by a noticeable increase in the borrowings of the Ministry of Finance, which financed the growing budget deficit with MEKAM issues. According to KASE, the annual volume of the primary GS market at the Exchange increased by 2.9 times compared to the previous year.

In addition, the country began implementing the state program to support shared construction participants. Real cash was received by the construction sector from several areas. As a result of the measures taken in 2008, the volume of commercial housing construction increased by 55% from 1.8 mln m² to 2.8 mln m², of which shared construction amounted to 2.4 mln m². It revived both the economy and the employment market.

But at the end of the year, devaluation expectations began to grow. They went in parallel with Russia, where the process of accelerated weakening of RUB-to-USD exchange rate started in fall. All this affected the tenge debt market and the money market.

Despite the unfolding crisis, and in some cases due to it, the Exchange continued to modernize.

Being convinced of the ineffectiveness of the division of the market due to RFCA entrance into the basic and special (also called the alternative) trading platform, KASE continued the efforts started in 2007 with ARA RFCA in this area. The first significant outcome was the opportunity of operating on an alternative platform of the Exchange without registering a special entity provided to KASE

members in early 2008. Subsequent efforts of KASE to reunify the market were mainly aimed at ensuring the equivalence of listing requirements for securities and issuers at KASE BTP and RFCA STP, which would ultimately allow uniting these platforms. These efforts resulted in introducing two regulatory acts, which not only established new listing requirements of regulators for RFCA STP and KASE BTP, but also identified a new, more complex structure of the official lists of both platforms.

After the introduction of the new rules, the official list of KASE consisted of seven sectors. In June, the Expert Council of RFCA STP and the KASE Exchange Council approved the reclassification of securities in the official lists of the platforms. The new listing requirements, as compared with the previous ones, were higher with respect to securities of the highest investment quality and their issuers. At the same time, the "entry threshold" for the official list of shares was reduced, so that in this category equity instruments of beginners and relatively small companies could then be traded, which had not been previously allowed. The principal innovations also included the use of credit ratings by recognized rating agencies as one of the criteria for selecting debt securities in the highest category of the official list.

A significant change in the listing requirements resulted in a discrepancy between a number of securities on the official list of KASE and their issuers with the listing requirements established by FSA resolution. However, in accordance with the FSA resolution, 25 titles of bonds by 24 issuers, which failed to meet the listing requirements of any of the categories (subcategories), were transferred to the second subcategory of the category Non-Rated Debt Securities, and 39 titles of shares by 33 issuers without a market maker got out of the KASE official list.

In order to keep these securities on the official list of KASE, FSA and ARA RFCA jointly developed a resolution of the FSA Board, according to which the requirement for a market maker for the third category of the Shares sector and the amount of the net profit for the second subcategory of Non-Rated Debt Securities was cancelled. In this connection, 36 titles of shares by 30 issuers, which turned out to be outside the KASE lists as a result of the reclassification, were transferred to the third category of the official list of the Exchange in September 2008.

The crisis had a negative impact on the number of securities listed on KASE. If in 2007 75 titles of securities went through this procedure at KASE BTP, then there were just 56 of them in 2008. The respective values for RFCA STP were 66 and 32, but the majority of listings there were made in relation to the securities already on the official list of KASE BTP. There were delisting events, as well...

KASE systematically supported issuers and investors and worked to reduce risks in general. In particular, as early as the beginning of 2008, amendments were introduced to the internal document of the Exchange, which established the avoidable limit of the securities price deviation of 30% of the price for the latest transaction in securities of certain categories. The Exchange also stepped up its work to increase the responsibility of participants in exchange trading for their default under securities sale and purchase transactions and repo transactions. The proposed amendments fundamentally tightened the requirements of the

Exchange to its members failing to fulfill their obligations under the transactions made and caused discussions and disagreements. Therefore, the Exchange could apply them in a slightly corrected form only in October (Membership Regulations²²) and December (Rules for Repo Transactions²³) 2008.

Very important amendments were made to the Methodology of Securities Valuation²⁴. It was the document that introduced the stepwise system of discounting the prices for repo transaction items, summarizing the painful experience of the defaults. The changes became effective on December 25; and on December 30, 2008, the KASE Board adopted the amendments to the Automated Repo Market Specification²⁵, which reduced the maximum duration of automatic repo transactions from 90 to 30 days starting from January 1, 2009. Despite the measures taken, the situation in the repo market remained bad by the end of the year. This required KASE and FSA to further tighten the rules in order to "clean up" this sector from pyramid schemes and to drastically limit the default risks of the participants in exchange trades in 2009.

Another important event for the Exchange itself occurred in 2008. KASE was preparing for an IPO of its own shares and for the first time ever prepared audited consolidated annual financial statements for 2007, 2006 and 2005. On August 25, FSA registered the issue of authorized ordinary shares of the Exchange. The volume of the issue amounted to 5 mln units and included 450 previously authorized and fully placed ordinary shares of KASE, taking into account their splitting in the ratio of 1:1,000.

As a result, KASE's 4,550,000 unplaced ordinary shares became potentially available to the retail investor. However, the completion of procedures required for KASE IPO was accompanied by drastic deterioration in market conditions. Therefore, on December 25, 2008, the Exchange Council made a decision to give up a public offering in 2008 and has never turned back to this issue later.

At the beginning of 2008, the KASE Corporate Governance Code²⁶ was approved, and then by the decision of the Exchange Council the Strategic Planning Committee was established. By the end of the year, KASE officially launched a new version of its website. Besides, in order to expand the list of financial instruments available to KASE members, KASE held the first trades in deliverable futures for refined gold in bullions on November 26, at the initiative of ARA RFCA. However, the project turned out to be very complicated and had no success with the members of the Exchange for a number of reasons.

Another project of the Exchange has been developed and remains a very popular instrument even ten years later. On December 29, 2008, the actors of the foreign currency exchange market could conduct currency swap transactions at KASE, attracting or placing short-term liquidity without paying special taxes or exchange fees. In a crisis of confidence in counterparties in the over-the-counter money market and high devaluation expectations, when the banks were not interested in reducing their currency position, the innovation was a prompt solution.

KASE gradually entered the international exchange community. In 2008, the first license agreement in the history of the Exchange was signed for the use of KASE stock index with one of the major international financial institutions. In addition,

the status of KASE in WFE (World Federation of Exchanges)²⁷ was upgraded from a Correspondent to an Affiliate.

By the end of 2008, KASE was well aware that the following year might be harder. And the main thing was the expectation of a decrease in the number of new listed companies due to the growing distrust of investors and the deterioration of the financial and economic performance of the majority of issuers of securities. So the year 2009 was expected anxiously.

THROUGH DEVALUATION AND DEFAULTS TO RECOVERY AND GROWTH

The 2009 year was a turning point for the global and Kazakhstan's economies. After a two-year period of economic recession and stagflation, the key global and Kazakhstan's economic indicators in 2009 reached their minimum extremes, marking the beginning of the recovery cycle. The difficult winter and spring of 2009 in Kazakhstan and all over the world predetermined a more favorable development of events in the remaining three quarters of the year.

At the beginning of the year, the global largest economies demonstrated a decline in production and foreign trade. US GDP in the fourth quarter of 2008 fell by 6.2%, which was significantly lower than analysts' forecasts. The financial statements of the corporate sector and the nationalization of the largest banks confirmed negative macroeconomic statistics.

Under the influence of negative news, analysts lowered their forecasts for consumption and production rates, while investors sold off equity and debt instruments, contracts for hydrocarbons and base metals. The S&P 500 Index reached a 12-year minimum of 684 points; the price for Brent crude fell below USD 40 per barrel, and the price for a three-month copper futures contract fell to USD 3,000 per ton.

The reduction in export currency earnings led to a deterioration in Kazakhstan's foreign trade statistics. The current account deficit of the balance of payments of Kazakhstan in the second quarter of 2009 reached USD 2.4 bn; the trade balance dropped to USD 2.1 bn. The net outflow of foreign currency from Kazakhstan, which began in late 2008, weakened the tenge positions, as a result of which the National Bank had to conduct a single 25% devaluation²⁸ on February 4.

The devaluation of the tenge was officially announced by Grigoriy Marchenko, who had recently returned to the post of the Chairperson of the National Bank. It was stated that NBRK had given up maintaining the tenge in the former implicit range and considered the new national currency exchange rate to be objectively necessary. The tenge exchange rate was set at KZT 150 per US dollar with a fluctuation of $\pm 3\%$, or KZT 5.

The position of the National Bank was justified by the fact that in the face of growing pressure on the national currency exchange rate in recent years, NBRK

made considerable efforts to ensure its stability and maintain the implicit range within KZT 117–123 per US dollar (KZT $120 \pm 2\%$). This allowed for economic and financial stability. However, “the need to maintain the current level of FX reserves and support the competitive ability of domestic producers requires a revision of approaches to monetary policy by the National Bank”. According to official data, for the period from the fourth quarter of 2008 to February 4, NBRK spent USD 6 bn (including 2.7 bn in January 2009 alone) to ensure stability in the currency market and to maintain the exchange rate in the existing range²⁹.

The National Bank also announced that it would strictly suppress any attempts at speculative behavior in the currency market. And in order to reduce speculative moods, it reserved the right to go beyond the lower boundary of the range, so that the strengthening of the tenge exchange rate caused the losses of speculators. NBRK made it clear that they would not allow fluctuations in the exchange rate that would exceed reasonable expectations, although the introduction of restrictions on the existing regime of currency transactions had not been provided yet.

There were several reasons for devaluation. The first reason was the decline in oil prices, since oil took about 60% of Kazakhstan’s total exports. The second one was the devaluation of national currencies in the countries-trading partners of Kazakhstan. This factor resulted in the strengthening of the real effective exchange rate of the tenge against the currencies of the countries-trading partners by 13% for 11 months of 2008, and by 16% if taking into account January 2009. And by 30% from 2000.

The protection of domestic producers was another solid reason for the devaluation of the national currency. They had a tough time. With the deteriorating situation of companies in the corporate sector and the failure to attract foreign financing, second-tier banks almost ceased lending to the economy in 2009. The subsequent increase in intercorporate debt led to the insolvency of large borrowers, further increased the share of non-performing loans and provoked the occurrence of defaults in the bond market of Kazakhstan.

The peak of default events fell to the spring-summer. By the end of 2009, 22 KASE listed companies announced default on bonds, and in total the default occurred for 58 titles of bonds for the year. This was 14% of the total number of listing instruments at the end of the year. The share of such instruments in the total capitalization of the corporate bond market reached almost 25%. However, only 13.7% of overdue debt was repaid by the end of 2009.

In the current situation, FSA and ARA RFCA, in cooperation with the Exchange, developed amendments to regulatory legal acts. Upon adoption of such amendments, the official list of KASE securities was supplemented with a new category for debt instruments – a buffer category. All cases, when the issuer’s securities were transferred to this category, were clearly described. At the same time, in 2009, the securities were transferred to such category only if the KASE Listing Commission³⁰ made such a decision. Otherwise, the securities were subject to delisting.

The innovation was aimed primarily at protecting the interests of investors, since the presence of securities in the buffer category did not exempt their

issuers from meeting listing requirements. Information on such securities and their issuers was still available to public, while the securities were available in the organized market.

Galina Tsalyuk, Managing Director, Director of the KASE Listing Department, recalled that difficult year as follows:

"When, during the last crisis, a number of securities listed on the Exchange defaulted, a question arose: what to do about it? It would seem easy to delist such securities. But after all they have investors – pension funds, brokerage companies and their clients. And if we delist the issuer's securities, then we will generally punish investors rather than the issuer.

We got an idea to create something like quarantine for such securities. And since the crisis did not affect us alone, we looked at what the London Stock Exchange did in a similar situation. They also began creating temporary zones on their lists, where they placed questionable securities for a certain period of time and watched them. We decided that the best option was to give investors the opportunity to track what was happening to the company, how it coped with the problems, what plans it had, how its management worked.

We created such a category and called it "buffer category", i.e. a temporary stage between the listing and delisting. We gave 12 months to the issuers of such securities to solve their problem. Anyway, they had to agree upon the restructuring of liabilities with their creditors. That helped. Some companies managed to withdraw their securities from the buffer category, and today they continue trading on KASE. There is one company that "crashed into the buffer" twice, but has returned and is now operating. This buffer category saved a big number of companies. This category still persists at the basic platform and at the alternative one – anything can happen, not so often, but defaults still happen today."

In 2009, the KASE Listing Commission reviewed the action plans to eliminate the grounds for transferring securities to the buffer category of 20 listing companies in total, while the securities of five issuers were delisted, and 15 companies were transferred to the buffer category.

In addition to the introduction of the "buffer" category, the updated Listing Rules provided for the Exchange's requirements to the level of ratings and rating agencies. Representatives of the FSA, Regional Financial Centre Almaty JSC and KASE told about this at a press conference in Almaty in October 2009. The regulatory requirement was supposed to come into effect as of January 1, 2010. However, the requirement for ranking availability applied only to those companies that were preparing to be listed. It was planned to admit companies with at least non-default rating to this category.

According to **Aigul Tasbolat**, who was deputy chairman of the Regional Financial Centre of Almaty JSC at that time, the rating was required mainly as an indicator that would help investors "navigate and make their choices".

If we turn back to the problems of the beginning of 2009, then they grew in the banking sector. At the end of 2008, Samruk-Kazyna National Welfare Fund JSC signed memoranda of understanding with four backbone second-tier banks that provided for the basic principles of their additional capitalization. In January 2009, deposits of KZT 120 bn were placed on the accounts of Kazkommertsbank JSC and Halyk Savings Bank of Kazakhstan JSC. On February 2, FSA recommended that the fund should additionally capitalize BTA Bank JSC by repurchasing additional 29.9 mln ordinary shares for the amount of KZT 251.3 bn (78.14% of the outstanding shares). On the same day, Samruk-Kazyna announced the purchase of a 76% stake of Alliance Bank JSC from Seimar Alliance Financial Corporation JSC and placement of additional KZT 24 bn on the bank account to maintain its financial stability and further additional capitalization.

The problems of the Kazakhstan's economy were projected onto the Kazakhstan's money market. In late 2008 – early 2009, speculations about the depreciation of the national currency and a failure to access foreign funding exacerbated the short-term tenge liquidity deficit. The money market rates in the first quarter of 2009 reached historical maximum: TONIA exceeded 19% per annum and three-month KazPrime reached 15% per annum in February.

With negative information received and an acute strain on liquidity, investors closed long positions in high-risk Kazakhstan's shares and bonds. By February 2009, the KASE Index reached its lowest level since 2006 – 576.89 points. The most negative dynamics was observed in ordinary shares of Kazakhtelecom JSC (–56.6% from the beginning of the year) and ordinary shares of Kazkommertsbank JSC (–45.9%). Ordinary shares of mining companies KAZAKHMYS PLC (–5.1%) and KazMunayGas Exploration Production JSC (–7.6%) were a bit better than the market.

KAZPRIME INTERBANK DEPOSIT MARKET INDICATOR

KazPrime is an indicator of the value of money when it is placed on the deposits of the interbank market among the banks of the best credit quality for Kazakhstan; it became effective on March 27, 2007.

The indicator calculation project was initiated by ABN AMRO Bank Kazakhstan SJSB JSC and implemented by the banks of Kazakhstan together with KASE supported by the Association of Financiers of Kazakhstan, the National Bank of the Republic of Kazakhstan and the European Bank for Reconstruction and Development.

KazPrime is calculated daily as the arithmetic average of the money placement rates in accordance with the quotations submitted to the KASE trading system by banks that are parties to the Agreement on the Indicator Generation. Each of these quotations includes the rates and volumes of attracting and placing money on interbank deposits, the unified term of which is three months (KazPrime-3M).

The Agreement provides that within 30 minutes after fixing KazPrime, the parties to the Agreement shall enter into transactions according to the quotations they have set, if there is a corresponding order made by any other party. It is the circumstance of the mandatory satisfaction of the quotation that makes this indicator representative.

The collapse of prices in the stock market led to the fact that the value of repo portfolios created using repo transactions turned out to be significantly lower than the value of liabilities on them. The first alarms went off in the fall of 2008, when under the pressure from a drastic fall in prices in the stock market, the share of extended repo transactions increased significantly. On December 18, 2008, the first event of default of a repo transaction closing was recorded.

In response to the situation, on January 1, 2009, KASE shortened the period of automatic repo transactions in the exchange market to 30 days. On January 8, the Exchange Council approved the amendments to the Rules for Repo Transactions that became effective on January 25; the Rules set the maximum period for repo transactions by the "direct" method as 90 days, taking into account all possible extensions (previously, the repo period was not limited). In addition, they introduced a ban on extending repo transactions by "automatic" method.

Innovations led to the fact that the owners of low-quality repo portfolios had no opportunity to extend their bad liabilities and in fact turned out to be in default. As a result, the Kazakhstan market of "direct" repo transactions was struck by a series of non-payments, the peak of which occurred in February – March 2009, when the share of overdue liabilities exceeded 25% of the total volume of transactions opened at that time in this sector of Kazakhstan money market; the extended liabilities amounted to 13%.

The measures described above were very painful, but apparently indispensable ones.

However, the Exchange moved forward. On April 1, 2009, the amendments were made to the Specification of the Automatic Repo Market to reduce the risks caused by the quality of the repo transaction items. The need for such changes was due to the events of default of corporate bond issuers, and a decrease in the level of transparency and quality of information disclosed by issuers. From that date on, it was prohibited to use repo securities, whose issuer defaulted on servicing its debt or failed to pay dividends on preferred shares, and the securities, whose admittance initiator made a material violation of its disclosure requirements, as items of repo transactions.

The approval of the Agreement on the General Conditions for Repo Transactions by "Direct" Method by the Exchange Council on May 28 – an annex to the Rules for Repo Transactions was a significant event of 2009. The Agreement was designed as a legal basis for the introduction of the mark-to-market system in 2010 – the continuous revaluations of liabilities for direct repo transactions based on the market value of a repo item, and the calculation and transfer of compensatory payments by the parties to such transactions in case of a critical change in prices for repo transaction items.

The mark-to-market system is a standard attribute of a developed repo market, and with its introduction, the Exchange hoped to timely identify and effectively level almost all types of risks arising in the market of "direct" repo transactions. However, time showed that the system did not work out in Kazakhstan's realities, and market actors could not manage their risks in this segment on their own. However, this became clear only in 2015–2016, but in 2009, the implementation of the above

measures by KASE and FSA to regulate the exchange money market proved to be effective: no new events of default of repo transactions in the exchange market were registered that year from mid-July.

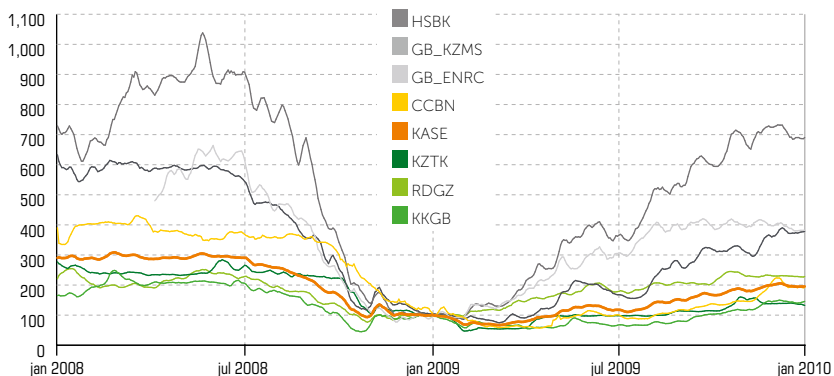
Other anti-crisis measures were also taken. In particular, on February 5, the refinancing rate was reduced by the National Bank down to 9.5%. On March 3, the minimum reserve requirements for second-tier banks decreased from 2 to 1.5% for internal liabilities and from 3 to 2.5% for other liabilities. As stated, this "will provide additional liquidity to the banking system in the amount of KZT 50 bn. By the way, the exchange offices will be provided with a sufficient amount of foreign currency cash from both banks and the National Bank, which additionally imported USD 600 mln."³¹

In mid-March 2009, a mechanism was launched by the National Bank to provide additional short-term liquidity to the neediest – Alliance Bank JSC and BTA Bank JSC. Both banks made a listing of their debt securities followed by a swap for the bonds of Samruk-Kazyna NWF JSC, which they used as an item of repo transactions with NBRK. When implementing this mechanism, the exchange infrastructure was fully used.

The first positive data on the state of the global economy came in summer 2009 from the USA and the Eurozone. Following the results of the second, third and fourth quarters, the GDP growth and inflation rates of the economic leaders demonstrated an improved situation, while the unemployment rate in the USA and the Eurozone reached its peak in the fourth quarter.

As more and more positive news were received from the global markets and various indicators grew, e.g., the Bloomberg Professional Confidence Index, which exceeded 50 points for the first time in August, marking the market expectations of a rapid economic growth, some positive things also started also appearing in the Kazakhstani market. It was mainly due to the state support measures. Only

THE DYNAMICS OF THE KASE INDEX AND PRICES FOR SHARES ON THE REPRESENTATIVE LIST IN 2009 AND 2008, % (JAN1, 2009 = 100)



within the framework of the government incentive measures, more than USD 10 bn were allocated to the economy, some of which remained on the correspondent accounts of second-tier banks in one form or another.

With a slowdown in lending, the inflow of state money into the economy led to the saturation of the money market with liquidity in the second half of 2009, the stabilization of TONIA at 0.5–1.0% per annum and a decrease in the volume of repo market borrowings. Starting from April 2009, KazPrime gradually decreased and reached 3% per annum by the end of the year.

The state budget deficit of 3.1% of GDP led to an increase in the national debt from 6.3 to 10.1% of GDP. The Ministry of Finance actively increased the issue of MEKAM, as a result of which the volume of trading in the government securities market increased by 50% in 2009 and amounted to KZT 1,408.1 bn.

Kazakhstan's equity market responded positively to internal and external news received. By the end of the year, the KASE Index was 98.2% (206.5% to the annual minimum), capitalization rate of the stock market increased by 84.3%. All shares on the KASE Index representative list were in the black.

With everything described above, KASE was engaged in less global tasks.

For example, it was important to settle the issue of merging trading platforms based on new listing requirements. There were opinions before that the two trading platforms for such a small stock market as the Kazakh one were too much. The crisis proved it in practice: in 2007, the trading volume on RFCA STP did not exceed 3.9% of the total volume of exchange trading in the stock and corporate bonds market, and in 2008 it was 15.2%.

A remarkable fact was that trading in securities at RFCA STP were conducted according to T+3 settlement scheme. However, no matters of settlement risks that inevitably arose when money and securities were delivered to CSD on the third day after the transaction were resolved. No margin was provided by the bidders, there were no clearing procedures or clearing funds, or the possibility of netting. The T+3 settlement scheme at RFCA STP provided no advantages to bidders, but created many inconveniences and even risks.

The existence of two platforms with different legal and tax regimes, where virtually the same securities were traded, gave rise to many disputable situations and unclarity in listing and investing in the Kazakhstan stock market. Eventually, this led to the fact that on November 9, 2009, after some law-making efforts made, both KASE and RFCA trading platforms ceased to exist, and the unified trading platform regulated by unified regulatory documents was launched. The "dual power" that brought confusion in the market, which was anyway going through the hard time, was over.

They continued improving the settlement procedures, working on improving the level of corporate governance. There was a transition to planning the main business processes. The KASE Board developed and adopted the Basic Action Plan for 2009. It meant that for the first time in the history of the Exchange, its activities were in accordance with the plan, which was approved by the governance body. In the same year, the Internal Audit Service, and later the Internal Audit Committee were established. In order to improve the transparency of the corporate structure,

the Exchange Council decided to buy out interests in its subsidiaries – eTrade.kz LLP³² and IRBIS Financial Market Information Agency LLP³³. Both transactions were closed in the same year.

All internal organizational changes and restructuring, correction of regulations, improvement of listing rules were made while the market was operating and affected the market performance. Some innovations had an immediate effect, others had a certain time lag. But this process proved that KASE was not passive, it was in the center of the financial market and together with actors and regulators solved its problems. It is clear that these activities could not be compared in its effect on the market with the global nature of the processes occurring in the world. But in combination with the large-scale crisis program implemented in the country at the state level, it could succeed.

*The Chairperson **Kadyrzhan Damitov**, who headed the Exchange on April 30, 2009, wrote in the preface to the KASE Annual Report: "The 2009 year brought not only new trials, but also the experience of making and implementing crisis decisions to the economy of Kazakhstan and especially to the financial market of the country. The measures taken in 2009 to preserve and further develop the financial system, including by KASE, were largely focused on stabilizing and improving the reliability of the domestic financial market, rather than on achieving maximum commercial results... Certainly, negative macroeconomic factors will still affect the market for a number of years. However, there is a reason to believe that the "bottom" of the crisis has already been passed. The support of the state, shareholders, the expertise of KASE specialists and the entire financial community of Kazakhstan made it possible for the Exchange to keep implementing large-scale projects in such a hard year and allows us to be confident about the sustainable development of KASE in future."*

* * *

Thus, the year 2009 was not yet a year of positive changes. But for the first time since the fall of 2007 the signs of stabilization in the economy and in the markets could be seen, and the first hopes for subsequent growth appeared.

The first decade of the new millennium, "having survived" all possible economic diseases, was eventually tempered. Next year, in 2010, Kazakhstan had to strengthen the successes on all fronts, i.e. the markets, including the exchange market.

Подписка на IPO KASE



Chapter 5 LEARNING LESSONS

THE FOUNDATION FOR A NEW LEAP
TRYING TO MAKE A START UP
TASKED WITH RISK MITIGATION

Chapter 5.

LEARNING LESSONS

The economy of Kazakhstan entered the new decade having certain hopes. The set of crisis measures of the government still continued to operate; a prompt nature and effectiveness of such measures made it possible to prevent a recession. The real increase in gross domestic product in 2009 was 1.1%, and the inflation rate of 6.2% was lower than the expected range of 8–8.5%. At the very first press conference in 2010, Grigoriy Marchenko, the chairperson of the Kazakh National Bank, confirmed that the National Bank intends to maintain the current foreign currency range until February 5.¹ Afterwards, until March 20, 2011 it would be expanded to KZT +15 (or 10%) and KZT –22.5 (or 15%). This meant that the value of the US dollar would fluctuate within the range of KZT 127.5–KZT 165.

There were quite a lot of assessments and comments on the economic situation in the country, but the assessment of the President Nursultan Nazarbayev in his Message to the People of Kazakhstan was a resulting and fairly accurate description of the starting positions of 2010²:

“The global financial economic crisis has affected the economy growth rates, but has not prevented our development. We found ourselves in a “breakthrough group” of countries with positive growth rates. Gross international reserves and assets of the National Fund have already exceeded USD 50 billion today, and have increased more than 25 times over the past ten years. It should be noted that last year we spent part of the funds, and today the volume of the fund is more than last December.”

Most foreign experts complimented Kazakhstan on an effective crisis exit strategy. Moreover, if at the beginning of the year there was only an emerging trend to improve the ratings, then by summer it already sounded affirmative. Fitch Ratings upgraded the country’s long-term sovereign rating outlook from “stable” to “positive”. The authoritative investment company, Troika Dialog, emphasized that Kazakhstan had survived the crisis better than Russia. And this was despite the later devaluation and riskier lending policies of local banks and real estate market actors. “The economy of Kazakhstan is in a safe zone. In spite of the risks, the Kazakhstan market is interesting for investors. There are undervalued companies in the republic, which can be profitable for investors.”³

THE FOUNDATION FOR A NEW LEAP

Successful Restructuring

The completion of the process of the debt restructuring of three major Kazakh banks in 2010, which had defaulted a year before, evidenced the end of the acute phase of the financial crisis in Kazakhstan. According to various estimates, the amount of written off debt of Alliance Bank JSC, BTA Bank JSC and Temirbank JSC was between USD 11 and USD 12 billion, and the rest was converted into shares and new bonds of these banks.

Commenting on the results of the restructuring, the Chairperson of the Agency of the Republic of Kazakhstan for Regulation and Supervision of the Financial Market and Financial Organizations *Yelena Bakhmutova* said:

“There was a lot of criticism that the restructuring of the three banks would put the clock back for the country for several years and that the banks would not receive money. But this is not true. Restructuring has become widespread not only in Kazakhstan, but throughout the world. This is a reality and an adequate response from the state to the challenges faced by the financial system. Partially forgiven debts of the banks have been accepted by the foreign investor community in a right way. In fact, investors assess the risks of a particular financial institution. All fears were too conservative, if not to say unjustified.”

The successful restructuring contributed to creating conditions in order to improve the situation in the banking sector and prerequisites for its development in the post-crisis period. The total estimated equity capital of the banking sector returned to positive values, having amounted to KZT 1,832.7 billion as of January 1, 2011 and having increased to KZT 919.1 billion from the beginning of 2010. The share of external liabilities of the banks in their total liabilities decreased from 33.6% to 23.9%. Most important, the public trust in the financial system as a whole was preserved.

The Time for Conservative Strategies

Taking into account the effects of the global financial crisis and assessing its impact on the securities market and accumulative pension system in 2010, FSA also focused on ensuring adequate protection of pension savings, improved efficiency of investment management, strengthened requirements for financial stability and reduced risks of APFs and professional market actors.

The requirements for the system of prudential regulation and risk management in APFs, methods for measurement of the fair value of illiquid debt securities

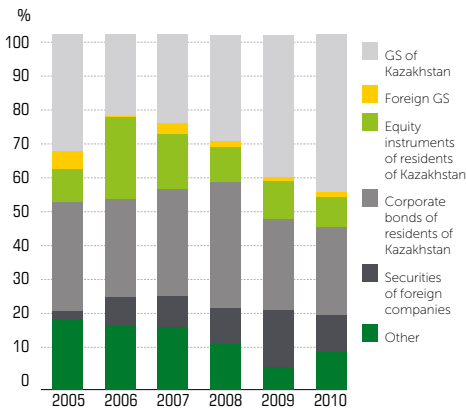
in investment portfolios were improved, additional restrictions were imposed on transactions with pension assets and own assets of APFs and management companies with affiliates. In addition, the regulator introduced a new system of investment limits in respect of financial instruments, taking into account the amount of pension assets.

Such “crackdown” was not always well accepted by market players; however, it allowed maintaining the APF capital adequacy as well as stabilizing and then growing pension savings and bringing the “net” investment income to a positive trend. By the end of 2010, the share of securities, whose issuers had defaulted on securities issues, fell to 1.54% of the total pension assets versus 3.8% a year before.

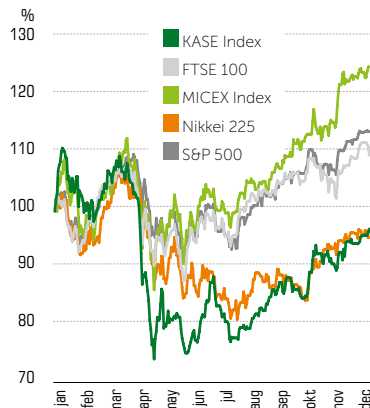
The joint efforts of FSA and KASE and, in particular, the creation of a buffer category stabilized significantly the situation in the Kazakhstan corporate debt market. According to KASE, the volume of outstanding debt decreased by 54% to KZT 94 billion in the second six months of 2010, and based on the results of the year, there were only nine defaulted issuers left on the official list of the Exchange. One of them repaid its debt in full, and three issuers restructured bonded loans. The remaining debtors were obliged by the Exchange to report on the progress in settling their obligations to the security holders on a quarterly basis.

And yet, despite the significant reduction in credit risks in the corporate sector, 2010 was the year of conservative strategies for the stock securities market. Following the requirements of the regulator and fearing new defaults, institutional investors preferred buying GS and corporate bonds of the highest investment quality. Priority was given to the securities of the Ministry of Finance – MEKAM. They were issued to finance the state budget deficit, which amounted to 2.89% of GDP based on the results of the year. As a result, the government securities market held

THE STRUCTURE OF THE AGGREGATED INVESTMENT PORTFOLIO OF KAZAKHSTAN'S APFS IN 2005–2010, %



THE DYNAMICS OF KASE INDEX AND MAIN FOREIGN INDICES IN 2010



MUNICIPAL BONDS: THE SECOND ACT

At the turn of the first decade of the new century, the municipal authorities have regained the right to issue bonds.. Relevant amendments have been made to the Budget Code of the Republic of Kazakhstan.²⁰ Starting 2007, only executive bodies of the city of national status (Almaty) and the capital (Astana) were allowed to issue bonds, albeit with some reservations "The volume and the purpose of the issue of government securities by local executive authority of the city of national status and the capital must be agreed with the Government of the Republic of Kazakhstan. The total volume of public borrowing of local executive bodies must not exceed the set debt limit of the respective local executive body."

Only two issues of municipal bonds – the city of Astana and Atyrau region due on June 24, 2007 and May 13, 2008, respectively – out of previously issued securities remained in circulation by 2007.

New issues of municipal bonds appeared only in 2010. Local administration of the city of Almaty placed 13 million five-year securities for the total amount of KZT 13.1 billion in the trading system of the Exchange on September 17 and October 1, 2010. The bonds' weighted average yield to maturity was 6.1536 % APR. The Subsidiary of BTA Bank Joint-Stock Company "BTA Securities" JSC acted as a financial advisor of the issuer and its underwriter as well as as the initiator of special trading sessions. The next market placement of this local

executive body was held only in 2017: local administration of the city of Almaty raised KZT 15 billion for the period of two years at 9.2 % APR.

The amendments to the Decree of the Government of the Republic of Kazakhstan *On the approval of the Rules for issuance of securities to circulation on the domestic market by the local executive body of the city of national status, the capital* No. 520²¹ dated October 2, 2009 were made in June 2016. According to the amendments, regional executive bodies were given permission to issue and place bonds, but only for the purposes of financing housing construction as part of implementation of state and government programs. Thus, the market of municipal borrowings received a boost. However, it did not have a significant impact on the development of this market sector. In this case, KASE infrastructure was used by the government as a platform for securities accounting and for making settlements. The executive bodies of Aktobe, Zhambyl, Akmola, West Kazakhstan, East Kazakhstan, Mangistau, Atyrau, Kyzylorda, Almaty, Karaganda, Kostanay, Pavlodar, North Kazakhstan and South Kazakhstan regions, as well as the cities of Astana and Almaty raised over KZT 200 billion within the framework of the above named programs for more than two years. The Baiterek National Management Holding JSC buys back all bonds through an authorized broker

the positions in 2010 and increased by 1.7% to KZT 1,431.4 billion in terms of the volume of transactions.

In the corporate sector, investors were, first of all, interested in bonds of state-owned and quasipublic companies, such as Kazatomprom JSC, KazMunayGas JSC and Development Bank of Kazakhstan JSC. According to KASE estimates, in 2010, the volume of corporate bonds attracted only through the Kazakhstan primary exchange market reached a record value of KZT 64.8 billion at that time.

The external background and high prices for the main export items of Kazakhstan contributed to the growth of foreign exchange market indicators. In 2010, the country's trade surplus reached USD 28.9 billion, and the current account surplus of the balance of payments amounted to USD 4.32 billion. The need for foreign exchange transactions between the actors of the currency market increased significantly, and as a result, the volume of trading in foreign currencies increased to KZT 15.7 trillion in 2010, exceeding the same value of the previous year by 59.4%. The speculative potential of the currency market remained low, and the USD exchange rate fluctuated within a rather narrow range (KZT 146.5 – KZT 148.0), which was controlled by the National Bank.

The year was characterized by the growing volume of dormant liquidity of banks, which led to lower rates and an increase in trading rates and volumes in the money market. The value of KazPrime 3M indicator had stabilized from June at around 2% per annum, and the TONIA indicator did not exceed 2.8% per annum during the year. The volume of trading in the repo transaction market in 2010 amounted to KZT 12.7 trillion and grew by 22% versus 2009 – there was indeed a lot of money in the market.

The Kazakh stock market sensitive to the uncertainties prevailing in the international stock and commodity markets was largely exposed to outside influence. In the middle of the year, with the fiscal crisis in the EU countries, investors all over the world began to sell off European assets and close long positions in securities of companies from developing countries, including Kazakhstan. Analysts' doubts about the sustainability of global economic recovery and fears of overheating of the Chinese economy added fuel to the fire. By late May – early June, following the main global stock indices, the KASE Index fell by 23.7% to an annual minimum of 1,349 basis points. The situation stabilized only in the fall, when the U.S. Federal Reserve System announced the beginning of the so-called second phase of quantitative easing, which provided for the redemption of government bonds worth USD 600 billion over the following eight months.

With this positive news, as well as under the influence of good macroeconomic indicators of Kazakhstan, by the end of the year, the KASE Index partially won back its fall to the level of 1,718 basis points. The leaders of growth were ordinary shares of Kazakhmys PLC (+18.1%), EURASIAN NATURAL RESOURCES CORPORATION PLC (+14.3%), Halyk Savings Bank of Kazakhstan JSC (+12.8%) and Kazakhtelecom JSC (+8.7%). The decrease for the year was shown by ordinary shares of Kazkommertsbank JSC (-33.5%), KazMunayGaz Exploration Production JSC (-20.9%) and Bank CenterCredit JSC (-22.6%). However, the overall performance of

the equity instruments market was disappointing – the trading volume fell by 56% to KZT 280.6 billion.

Privileges for Old-Timers and Entry Bonuses for Beginners

The events in the stock market showed that the problem of lack of liquidity at KASE under the conditions of global instability had worsened. But the Exchange and regulators did not give up. On June 9, 2010, KASE made a decision to introduce an additional benefit for issuers of the best traded securities in the Exchange: if the amount of commission fees on transactions made in the previous year with shares of any denomination exceeded 2,000 MCI, then the annual listing fee for such securities would be reduced to 100 MCI. This privilege was developed to reward the companies that maintain relatively high levels of free float and ensure constant communication with shareholders, thereby stimulating the liquidity of their shares in the open market. At the end of the year, two companies received such a benefit – KazMunayGas Exploration Production JSC and KAZAKHMYS PLC.

By combining efforts with ARA RFCA and RFCA JSC, the Exchange also managed to get support of a long-standing idea of bringing shares of large national and quasi-public companies to KASE from the Head of State and Government. The efforts were intensified after a special assignment given by the Prime Minister Karim Massimov in May 2010 as part of the implementation of the Strategic Plan 2020; a developed domestic stock market should have become one of the basic conditions for the implementation of the Strategic Plan. Soon, a special workgroup was established. It was proposed to place stakes of a number of subsidiaries of Samruk-Kazyna NWF JSC in the domestic stock market in August, IPO conditions were developed, and KASE was identified as the main trading platform.

The Exchange and ARA RFCA developed and amended the KASE's Listing Rules to provide for incentives for the companies that were planning an initial public offering of shares. Thus, from August 25, 2010, the initiators of admission of shares to circulation on the Exchange were exempted from paying the entry fee and first annual listing fees, if: the shares were included in the KASE official list for the first time; KASE made placement by a method of open outcry; the sum attracted based on IPO was at least 1 million MCI; the placed shares were bought by at least 50 investors, and the number of such shares in free circulation was no less than 10% of the total number of the issuer's shares. In addition, from August 13, 2010, new issuers could count on expanded free information support of KASE when conducting an exchange IPO to promote their activities among investors.

In order to "compare notes" and establish a productive dialogue between the state and the business community, the Exchange in cooperation with RFCA JSC held a two-day forum Kazakhstan Stock Market. IPO at KASE in November.

New Rules for Market Makers

The organizational measures taken to improve the liquidity of securities at KASE included the new rules for the activities of market makers approved by the Exchange Council on June 25, 2010. The main innovation consisted in a more detailed system of spreads, taking into account the risks and investment quality of quoted instruments. The maximum value of the spread between the best mandatory sale-and-purchase quotations of the market maker for the shares of the highest category on KASE official list and liquid shares was set at 7%; for illiquid shares and units – 10% of the purchase quotation value; for bonds – 4% of the difference between the yields of sale quotations and purchase quotations; for the bonds without the yield calculated by the KASE trading system – 8% of the difference between the prices for sale-and-purchase quotations relative to the price for purchase quotation⁴.

For a failure to fulfill their obligations to declare and maintain mandatory quotations in a timely manner, market makers had to pay a penalty in the amount of 20 to 200 MCI, depending on the period of such failure⁵. At the same time, they were given the opportunity to use “timeouts”, i.e. time intervals within the trading day to set new values of mandatory quotations, when it was permitted not to maintain mandatory quotations. The total duration of timeouts within a trading session should not exceed 30 minutes for liquid shares, units and bonds, and 15 minutes for illiquid shares.

The new rules also provided for benefits and a system of incentives for market makers based on their monthly performance. The category of specialists, which played one of the key roles in the corporate securities market in the period of its formation and rapid growth, was abolished due to the lack of demand by the Exchange members in the changed conditions. The new version of the document was approved by FSA on September 17, 2010 and put into effect on January 17, 2011.

Derivatives Market: Restart

In 2010, a project was launched to resume trading in futures at KASE. The Exchange had made some attempts to launch the derivatives market before. In 1996 and 1999, trading in futures contracts for the USD to KZT exchange rate opened; in 2001 – in futures contracts for the USD-to-EUR exchange rate; in 2002 – in futures contracts for the yield of international securities of the Republic of Kazakhstan; in 2008 – in deliverable futures contracts for fine gold in bullions. Despite the recurring activities of the parties to trading in futures contracts for the USD to KZT exchange rate from 1999 to 2004, the derivatives market eventually ceased to exist.

Historically, it was important for the Exchange in the project of revival of the futures market that for the first time the Exchange undertook the functions of a central counterparty and guaranteed the enforcement of the transactions

made within the limits of the amount of clearing funds. The risk management system fundamentally new for the Kazakhstan market, which met international standards, included three elements: a system of limits for opening positions and price changes depending on the adequacy of funds in the party's account, a margin system to cover the risks of price changes, and a guarantee and reserve funds to ensure timely clearing of transactions in the event of a default of one or several parties.

The Exchange undertook the formation and replenishment of the reserve fund, which amounted to KZT 170 million, at the expense of the monthly contributions of 15% of the amount of commission fees in the derivatives market, and guarantee funds were created for each type of term contracts separately from the mandatory one-time fixed contributions of the market members.

In the second six months of the year, the Exchange agreed with FSA and introduced the Rules for Exchange Trading in Futures Contracts, the Rules for Clearing Activities in the Derivatives Market and the Regulations on the Reserve and Guarantee Funds, and also conducted a demonstration game on trading in futures contracts for its members. And on December 6, trading in futures contracts for the USD to KZT exchange rate and for the KASE Index with the new risk management system was launched in a "combat" mode.

One of the main objectives of trading in futures contracts was the possibility of hedging risks. For example, if a management company had a portfolio correlating with the KASE Index, then by buying a futures contract for the KASE Index, it could insure itself against falling prices for shares on the representative list of the index. In the current market conditions, it was essential. Nevertheless, activity in the new sector remained extremely low, since hampered by legislative restrictions on the participation of APFs and open-end funds.

* * *

With such results, the Exchange entered 2011, which was to be the first in the implementation of the new three-year KASE Strategic Plan aimed primarily at a fundamental improvement of the reliability of the exchange market and the liquidity of traded financial instruments. Moreover, the foundation for movement in this direction had already been created. For the first time in the history of the Exchange, the existing trading and post-trade technologies were analyzed all over the world with a view to their potential use at KASE. The results of meetings and negotiations with representatives of LSE, NASDAQ OMX, KRX, RTS, MICEX, providers of exchange information technologies, such as Calypso Technology, Cinnober Financial Technology AB, Trayport, CPM Ltd, Financial Technologies, List Group, CMA allowed – in addition to a multivariate analysis of potential options of upgrading of the software and hardware complex and development of financial models of the Exchange – formation of a new vision for the future development of KASE. Including potential engagement of a strategic partner. In 2010, the Exchange transmitted trading data online to the world's largest market

information providers Thomson Reuters and Bloomberg for the first time, using international standards and protocols recognized in this area.

The regulator also had certain clarity. Commenting on the results of 2010, the Chairperson of FSA, **Yelena Bakhmutova**, highlighted that despite the existing problems, all the components formed for the successful implementation of IPO in Kazakhstan.

"I think that the placement of the shares by companies will allow solving the problem of an increased number of instruments traded, will contribute to the growth of liquidity and capitalization of the securities market. Moreover, the IPO contributes to the strengthening of the country's competitive advantages, the inflow of foreign investment and improved appeal of the Kazakhstan stock market."⁶

TRYING TO MAKE A START UP

For 2011, the country's financial authorities initially formulated the task to consolidate the successes of the previous year. Indeed, in 2010, the external debt of Kazakhstan reduced significantly, by almost 3 times. At the same time, foreign exchange reserves grew: with the reduced external debt of the banking sector by USD 29 billion, they increased by USD 17 billion. The growth of Kazakhstan's GDP was 7.3%, approaching the pre-crisis values.

Positive trends also characterized the national currency's well-being – despite the wide range of exchange rate fluctuations in 2010, the tenge strengthened by 0.6% in nominal terms. The regulator hardly participated in the market. Therefore, in January 2011, the Chairperson of the National Bank of Kazakhstan, Grigoriy Marchenko, stated that the National Bank saw no need in further tenge exchange rate fluctuation range and on March 21 it would return to the controlled floating exchange rate regime that had existed before 2009.

In May, the International Monetary Fund noted the anti-crisis actions taken by the Government and the National Bank. IMF Mission Chief, Ana Lucia Coronel, among the positive changes mentioned "a decrease in the sovereign risk of Kazakhstan, especially obvious compared to other countries in the region"⁷. She identified the need to reduce pressure on the budget as one of three important tasks of the government.

In November, the international rating agencies Fitch Ratings and Standard & Poor's almost simultaneously upgraded the country rating of Kazakhstan to an investment level. S&P upgraded the sovereign foreign currency credit rating to "BBB+", with a stable outlook. Fitch Ratings upgraded a long-term foreign currency rating from "BBB-" to "BBB" with a positive outlook.

Commenting on these events, KASE Vice-President **Andrey Tsalyuk** emphasized their practical significance for the entire stock market:

ASSISTANCE FROM EBRD AND VIENNA STOCK EXCHANGE (WBAG)

Kazakhstan Stock Exchange Capacity Building Project was launched in 2010 with the support of the European Bank for Reconstruction and Development (EBRD). This project was aimed at improving the liquidity of securities on Kazakhstan's organized stock market and at improving quality of services provided by KASE to issuers and investors. Professional stock market experts from CAPMEX (The Capital Market Experts, a member of the Vienna Stock Exchange), an Austrian consulting company, with high professional qualifications and extensive experience on the various stock markets started working on the project. In the course of six months, CAPMEX consultants learned the developmental problems of Kazakhstan's stock market, examined factors affecting the liquidity of securities in Kazakhstan's stock market, explored market data dissemination system used on KASE and conducted number of trainings for KASE staff and market participants. The result of their work was the final report and the list of specific recommendations that were taken into account when developing the strategy of KASE for 2011–2013.

According to the overall assessment of KASE specialists and market participants, who worked with the consultants, the project was very useful in many aspects including in the dialogue of the market with the Government and the regulator because they paid more attention to foreign experts' opinion.

One of the results of cooperation of KASE with CAPMEX as part of the Kazakhstan

Stock Exchange Capacity Building Project were the agreements made with Wiener Börse AG (WBAG) aimed at promoting KASE's information services on the international market, as well as indices calculation and dissemination. The Partnership with WBAG was aimed at enhancing recognition of KASE on the international arena in addition to the geographical expansion of information of KASE. Being a recognized informational hub specializing in the dissemination of market information in Europe, WBAG helped disseminate information of KASE among its numerous clients.

The fact that the vector of development in the area of trading data dissemination and that this area of activity is a promising one have been confirmed during the first year of the partnership when SIX Financial Information Ltd and Investis Ltd, who expressed interest in the dissemination of KASE's trading data, became involved.

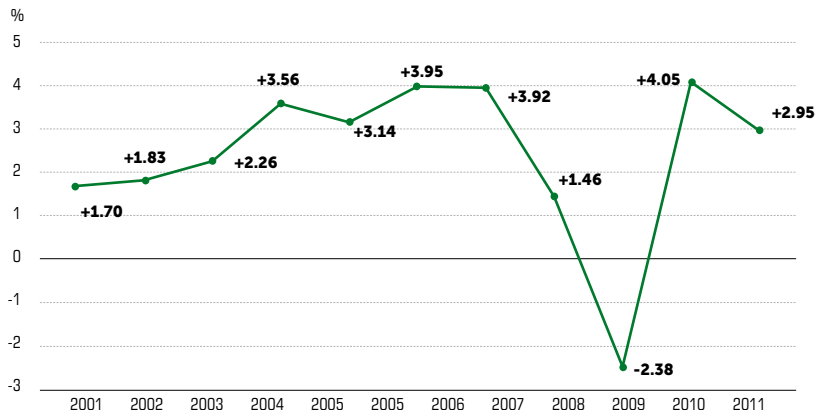
In subsequent years, in partnership with WBAG, KASE has attracted 12 foreign companies, including such major representatives of the financial market as Citigroup Global Markets Ltd, S&P Global Inc. (former SNL) and Statpro Canada Inc. As a result, average increase in income from sales of information for the whole period of cooperation amounted to 43%, which demonstrates the growing interest of foreign participants in Kazakhstan's financial market.

WBAG has also been calculating and disseminating Kazakh Traded Index (KTX) based on the market data submitted by KASE since 2013.

"It is very important for Kazakhstan that we have taken the lead in the S&P rating table in the former Soviet Union. Now we have the highest investment foreign currency rating. Therefore, the prices for the sovereign bonds should be higher. The event has been slightly obscured by the negative news of the world's markets, but it gives a head start for the future. The Ministry of Finance of the Republic of Kazakhstan has recently announced a preliminary intention to issue sovereign Eurobonds in 2012. These securities, or rather their value, will be regarded by investors as a benchmark for investment in corporate and quasi-public Kazakhstan issuers, which is essential. The increase in the sovereign rating, of course, will play into the rising value of the Kazakh securities. This means that the issuers placing their debt instruments after the described event will be able to count on a higher price and, consequently, a lower yield."⁸

The rating upgrade happened in the right time also from the point of view of the performance of the upcoming People's IPO, since interest in it from abroad was unexpectedly high. According to **Andrey Tsalyuk**, "After all, the securities will be offered to the public, and if the securities prices start growing, many people will want to sell the shares. At the same time, foreign investors attracted to Kazakhstan by an upgraded credit rating can act as buyers that will create additional demand and will not allow the prices to drop significantly. The country's rating upgraded by S&P can have such an indirect influence."

THE DYNAMICS OF THE GLOBAL GDP IN 2001–2011



Cautious optimism consolidated at all levels. However, there was an understanding that the outside environment was still not so favorable for the economy and might well bring down what had been gained over the past year. Unlike Kazakhstan, the world had not so much optimism. Structural imbalances had accumulated in the global economy. If in 2010 there was a thesis about the post-crisis recovery, then in 2011 many experts started talking about a new wave of the global crisis. The actual performance of the world economy had worsened; the cost of borrowing had increased for many countries, having a direct impact on economic performances. Looking for reasonable schemes to avoid losses or increase profits, investors often changed their preferences in choosing certain assets, thereby washing out liquidity and increasing volatility in global commodity and stock markets.

All this prevented Kazakhstan from "making a start" from the foundation laid in 2010. The objectives of all programs under development in the country, prepared draft laws, and regulatory reforms were proactive, aimed at preventing risks and potential defaults.

Following the Same Path as the Regulator

In early 2011, FSA announced a new regulatory approach. The preventive nature of the measures and the counter-cyclicity principle were the priority, i.e. announce the toughening standards in advance rather than introduce the same at the crisis moment. At that time, FSA Chairperson, Yelena Bakhmutova⁹, reported on the joint development of a program in cooperation with the government to rehabilitate large and medium-sized enterprises and to allocate bad assets to specially established separate companies, and also presented an action plan for the implementation of the Roadmap for the Development of Accumulative Pension System and Securities Market.

The set of measures laid down in the Roadmap was designed not only to "extend" the situation with the depreciation of assets of the accumulative pension system, but also to help in effective investment of pension funds, in general, contributing to the entrance of investors and issuers to the organized securities market and their active trade in the market.

When reporting at the Kazakhstan Financial Forum, **Alina Aldambergen** explained the position of the regulator:

"We are now discussing not only which companies will perform IPO, but also the conditions for IPO and whether they will enter the foreign stock exchanges or only the local ones. The Agency has the opinion that, first of all, national companies, including the quasi-public sector, should enter the domestic stock exchange. We believe that there should not be the second listing on the foreign stock exchanges. The Agency will not introduce any strict requirements to this end yet, since there are different opinions in the market regarding the listing of the Kazakh companies on the foreign

exchanges. It is believed that we have an insufficient investor base. To my mind, the matter is not about the investor base, the matter is about an interesting issuer. If the issuer is interesting, then the investor base will come to Kazakhstan on its own.”¹⁰

As an insurance against deliberate defaults, it was planned to establish legal obligation for issuers to redeem issued bonds in the event of voluntary delisting from the stock exchange or forced delisting for failure to comply with the listing requirements for disclosure.

Along with this, the regulator intended to strengthen the responsibility of financial advisers, who placed securities; representatives of bondholders and auditors, who made up a report for the stock exchange. An important set of issues concerned the protection of investors in terms of legal risks.

*The FSA Chairperson, **Yelena Bakhmutova**, explained: “In particular, it is proposed to develop amendments to the current legislation in respect of the introduction of regulation of rating agencies, and to consider the possibility of upgrading the status of a financial court to the regional level in order to assign all the risks of transactions, which will be made in the organized market, to its competence as well as all civil cases of appealing against the actions of the Kazakhstan Stock Exchange, the Central Depository and the regulatory bodies, such as FSA and ARA RFCA.”¹¹*

These and other standards and proposals should have come into effect as early as 2011 or should form the basis of the Law *On Risk Mitigation* under development. As a key element of the stock market infrastructure, KASE was actively involved in the implementation of the regulator’s intentions.

Thus, on April 6, 2011, the KASE Exchange Council approved a new Methodology of Securities Valuation, including for the securities in the investment portfolios of Kazakhstan’s APFs and asset management companies. The Methodology was prepared by experts of the Exchange for almost a year, and the impact of these efforts on the value of pension assets could not be overestimated.

On April 12, there was an event that significantly changed the state policy in the field of financial market regulation, which was embodied in the establishment of a “mega-regulator”. The Head of State signed a decree abolishing the Agency for Regulating the Activities of RFCA and FSA, and their functions and powers were assigned to the National Bank, and two committees were created in the structure of the National Bank: the Committee for the Control and Supervision of the Financial Market and Financial Organizations and the RFCA Development Committee.

Back to the Red

Although the country’s economy was clearly entering the post-crisis trajectory, year 2011 was frustrating for the stock market. They failed to maintain the dynamics

of 2010, when total turnover at KASE grew by 34%. The trading volume remained at the same level, with a decrease by 3.1%. It should be noted that there was a simultaneous decline in two sectors of KASE – foreign exchange trading and repo transactions, which had traditionally been the main “locomotives” of exchange trading statistics.

The trends in the global commodity markets, which had a strong influence on the domestic situation, were multidirectional: the prices for industrial metals mainly demonstrated negative dynamics, the cost of Brent crude oil, by contrast, grew by 14% in 2011, ending at USD 108 per barrel.

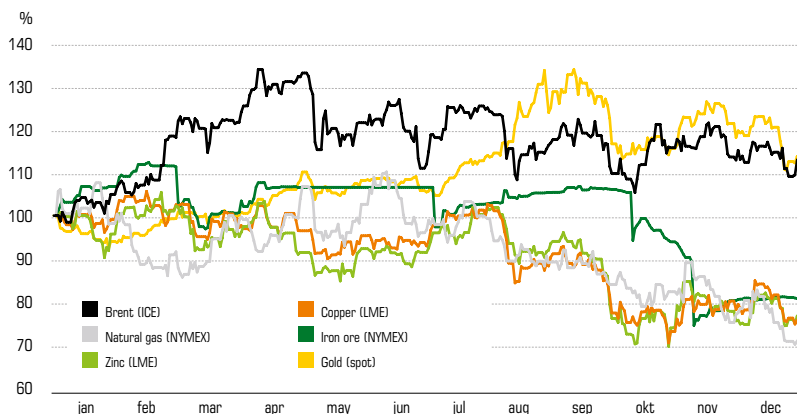
Despite the increased export proceeds from oil sale and the share of KASE in comparable currency market transactions from 71.9% in 2010 to 83.9% in 2011, the volume of foreign exchange transactions of STBs hardly changed, thereby violating the pattern of previous years, where increased export proceeds resulted in increased accumulated funds in bank accounts and increased volume of foreign currency transactions. The number and daily volume of transactions in the currency market gradually reduced during 2011.

The situation at the exchange trading in the Russian ruble for tenge also looked paradoxical. Despite the significant increase in stock turnover with Russia caused by the launch of the Customs Union, the volume of transactions with Russian rubles at KASE in 2011 decreased by 9.4%.

The speculative potential in the currency market remained low. Fluctuations of the tenge exchange rate to the main reserve currency of the world fell within the range between KZT 145.81 and KZT 148.43 per US dollar. Based on the weighted average exchange rate of the morning session, the level of the tenge weakening against the US dollar was 0.61% in nominal terms (0.65% in 2010).

Despite the growth in the currency earnings of exporters, the highly liquid assets of banks decreased by 9% in 2011, while the loan portfolio grew by 11%. However,

CHANGES IN PRICES FOR METALS AND RAW MATERIALS IN 2011



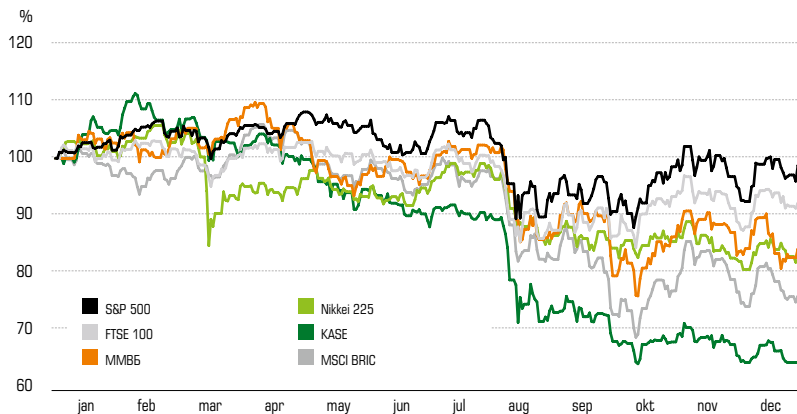
the decrease in excess liquidity of the banking sector was not sufficient to have a noticeable impact on the KASE money market. The TONIA and TWINA indicators showed working volatility in a sideways trend, while the KazPrime indicator remained at the same level of 2.0% per annum. The volume of repo exchange transactions remained virtually unchanged compared to 2010.

The rates in the corporate debt market tended to grow. This was due to the negative sentiment in the stock market associated with the expectation of a new wave of crisis, especially in the second six months of 2011, and continued defaults of KASE listed companies and, as a result, the cautious attitude of investors to bonds of medium and relatively low investment quality. The volume of trading in the corporate bond sector grew by 9% mainly due to trading in liabilities of the most reliable issuers.

The sentiment of investors in the equity securities segment had already been naturally dictated by the situation in the global financial markets. The events of 2011, such as the aggravation of the European debt crisis, the problems with the US government debt and the Fukushima Daiichi Nuclear Power Plant disaster in Japan, were reflected in one form or another in the Kazakhstan market. Only the first six weeks of 2011 turned out to be positive. From mid-February, the KASE Index rushed down at an increasing rate and stabilized a little bit only at the end of the year. The year resulted in the decline of this indicator by 35.7%, whereas it was only 2.8% in 2010.

In 2011, the KASE Index showed a more negative picture than the basic stock indices of developed markets. And this was despite the fact that the most developed countries were the source of problems in the global economy. The reason was in the weak diversification of the KASE Index, whose representative list consisted of shares of only seven issuers. The remaining shares on the KASE official list had almost zero liquidity.

CHANGES IN MAJOR STOCK INDICES IN 2011



The sharp drop in the KASE Index caused an outflow of investors' money from Kazakhstan's market, increasing liquidity risks and, therefore, depriving the market of the opportunity to recover quickly, as happened at better developed platforms. Accelerated drop in the index was accompanied by decreased trading volume, which resulted in the KASE share market losing 43.2% of its turnover at the end of 2011, and its year-end capitalization was estimated to be equivalent to USD 43.3 billion, i.e. decreased by 28%.

The GS market of Kazakhstan turned out to be a little apart from these events. The rates there remained stable, since APFs continued to increase the GS share in their portfolios under the influence of changes in the legislation, demonstrating consistently high demand at the auctions of the Ministry of Finance. The described situation manifested in the most characteristic way by the end of 2011, on the eve of the introduction of a multi-portfolio pension system. On January 1, 2012, APFs should have divided investment portfolios into conservative and moderate ones. Assets of beneficiaries of the retirement age by default fell into the conservative portfolio, which included no investment in stocks; and the rest were in the moderate portfolio, up to 30% of which could be formed by equity securities. (Later, on January 1, 2015, an aggressive portfolio should have appeared with the proportion of shares up to 80%, but, as is known, by that time it was decided to close the system of private APFs).

Along with the correction of prudential regulation, this led to a significant drop in intensity in the secondary GS market. Trading volume reduced by almost 40% compared to the previous year. The total volume of auctions in the GS market amounted to KZT 674 billion, which was 5% less than the volume of MEKAM placement planned by the Ministry of Finance in 2011. The state budget deficit fell to 2.1% of GDP.

Better Service – More Investors

The vulnerability of the Kazakhstan exchange market, which largely depended on the state of affairs of institutional investors represented by APFs, was obvious, therefore in 2011, KASE focused on strategic projects, whose implementation allowed expanding a number and geography of investors operating on the Exchange.

Great attention was paid at the project of commissioning the gateway, through which any trade terminals that supported the FIX (Financial information eXchange) protocol used in the developed world could be connected to the KASE trading system. This was to significantly expand the potential of the investor base of the Exchange. In addition to user-friendliness, the FIX gateway had another important advantage, i.e. reducing trading delays. Market data was transmitted to subscribers immediately after the registration of transactions in the trading system of the Exchange. The refresh rate of the depth of market via the FIX protocols significantly exceeded the rates achieved when working via other protocols.

In August 2011, the beta testing of the transactional FIX gateway was launched. On September 20, eTrade LLP arranged a presentation for professional players, and on November 21, 2011, the gateway was put into commercial operation.

As part of the development of Internet trading in June 2011, the Exchange launched the new online platform STrade, which was offered to members of the Exchange as a remote trading terminal in the securities market (the so-called "thin client"). A year before, the platform had been tested in a series of demonstration and test games for students, university professors and private investors as part of the training project Exchange Simulator (see the Box).

To ensure the safety of transactions, a mechanism was implemented in the STrade system to support digital signatures that met GOST 34.310-2004, and certificates of keys of digital signatures issued by the KCIS Certification Center. Data confidentiality was ensured by organizing a secure communication channel.

The launch of the platform also expanded KASE's opportunities in improving the financial literacy of the population. The function of connecting to the training trading system of the Exchange was added to the new terminal, which allowed potential beginners to use STrade to master their skills of trading in the stock market.

Guaranteed Reliability and Attractiveness of the Market

The following very important project was the transition to the guaranteed T+0 settlement system, whose development started in 2010. The goal of the project was a qualitative improvement of the reliability of settlements and mitigation of the risks of parties to transactions. This scheme provided for 100% pre-depositing of funds by the parties to securities trading in CSD, and the assets were monitored by the Exchange at the stage of filing bids to TS. This was done through the connection with the CSD systems – information on the balances in the accounts of each trading party was loaded before and during trading from the CSD system to the KASE TS. If a bid submitted to the trades was unsecured with securities or money, it was rejected. This made it possible to drastically reduce the number of cases of defaults on the transactions made at KASE. Prior to the introduction of this system, a securities transaction at KASE was first made, and only then the possibility of its execution was checked. For this reason, e.g. in 2010, the share of defaulted securities transactions at KASE reached 0.7% of the total number of sale and purchase transactions made. In 2011, prior to the introduction of the new settlement scheme, this indicator was 0.4%. All this scared off investors, especially foreign ones.

The T+0 project was implemented step by step to reduce any potential operational risks of market actors. On November 1, the system was launched into an operation and there was not a single case of a defaulted securities purchase and sale transaction recorded at KASE until the end of the year.

The successful implementation of the fully secured T+0 settlement system for securities transactions became the basis for the development of the partially

secured T+n ($n > 0$) settlement system. Due to this, the Exchange had advanced much in understanding the risks and problems directly related to the introduction of the T+n settlements. KASE also developed a set of rules governing the conditions and procedure for the operation of the stock market sector using clearing and partially secured T+n (with $0 < n < 4$) settlement system, because it was impossible to introduce T+n without significant changes in legislation.

Super-Objectives of the People's IPO

The process of preparing the country for the People's IPO ran like a golden thread throughout 2011. First, the Head of State clearly expressed his opinion. **Nursultan Nazarbayev** emphasized:

"Today, the whole world makes money from the stock market. The Kazakhstanis should also learn how to do it."¹²

In turn, **Karim Massimov**¹³, who headed the government at that time, outlined the priorities of the People's IPO:

"First, the development of the local stock market is impossible without the involvement of the population, citizens of the country. Second, despite the fact that the company is state-owned, it should be managed as private, as a company of a public interest which can be listed on the stock exchange. Third, in the 1990s – the years of privatization – the country focused on attracting a strategic investor rather than an institutional one. Now it is the time to really develop the stock market."

The prime minister also stated the sequence of stock placement: the first step was to sell the shares to the population, citizens of Kazakhstan. The second step was to sell to institutional investors – accumulative pension funds.

"We do not set the task of maximizing profits for the state when selling shares. We think more about the investor – a citizen and a pension fund. This is a unique opportunity that should not be often repeated. But the sharing of income and the creation of an average investor in the country is a very important aspect – not only an economic one, but also a political and social aspect of this issue."¹⁴

The prime minister thought that it was necessary to choose the moment when "the market is not very good, not at the peak of the market, but, on the contrary, at worse times, before the rise". And the year 2011 looked appropriate in this sense. Soon, the Governmental Resolution dated September 8, 2011 approved the Program for the Placement of Stock of Subsidiaries and Affiliates of Samruk-Kazyna National Welfare Fund JSC on the Securities Market.

Since all political decisions had been made, KASE, which was chosen as the platform for the People's IPO, began preparatory work. The Exchange got the task to upgrade the technical capabilities of the KASE trading system by 20–30% by the beginning of the IPO. To organize a subscription during the People's IPO, a special module was created for the collection, consolidation, processing of bids from market actors and generation of summary data. The Exchange specialists attended the meetings with consultants, who worked on the program, gave their suggestions, conducted regular explanatory work among the population through publications in the media. At the same time, the internal documents and information systems of KASE were amended. The Rules for Placement of Shares, approved by the Exchange Council in March 2012, were developed.

On the Way to the Corporate Governance Standards

A whole series of KASE measures was associated with mitigation of risks in its activities. The need to create an internal risk management system was recorded in regulatory terms by FSA back in 2009. At that time, the Internal Audit Service was established, whose tasks included the inspection of the main business processes of the Exchange. In 2010, shareholders more than doubled the authorized capital stock of KASE, creating a "margin of safety" for the Exchange to meet the prudential standards. By order of KASE, Ernst & Young conducted a technical audit of the IT processes of the Exchange and gave recommendations for improving the quality of information systems operation.

In 2011, the Risk Management Service established a year before proceeded to the development of plans to ensure KASE's continuous operations in accordance with British Standard BS 25999. The availability of the plans was a condition for the Exchange to become a WFE Member. Following the results of the work with almost all the departments of the Exchange involved, the Resolution of KASE's Management Board of December 2, 2011 approved the Rules for Ensuring Business Continuity and Recovery, the Emergency Response Plan, the Crisis Management Plan, and the Exchange Recovery Plan.

In addition, they continued arranging the remote backup center of the Exchange in Kaskelen (Almaty Region), whose construction was completed in 2010. The infrastructure was created to house hardware, all data transmission channels were installed and tested, the center was equipped with server equipment and other hardware. The launch of the backup center allowed maintaining trades even in the event of the failure of the main trading center, which guaranteed the continuity of KASE's business at a qualitatively new level.

Ships of All Flags will Come to Us

The Exchange kept integrating with the international exchange community. An important milestone there was that KASE President Kadyrzhan Damitov

became a member of the Executive Committee of the General Assembly of the Federation of Euro-Asian Stock Exchanges (FEAS) in December 2010. The goal of FEAS, where KASE has been a member since 1997, is to assist in the development of stock markets in the Eurasian region and to promote business cooperation between stock exchanges and professional stock market players. KASE was the first exchange in Central Asia to become a member of the Executive Committee of this organization. This decision was made at the regular General Assembly in Istanbul, and in the fall of 2011, KASE hosted the 17th FEAS General Assembly in Almaty. A marketing exhibition was organized as part of the Assembly, where the participants of the Kazakhstan stock market learned about the activities of stock exchanges-members of FEAS.

At the same time with the FEAS Assembly, the first meeting of the OECD Eurasian Group on Corporate Governance on the development of the stock market was organized, which was attended by heads of regulatory authorities and exchanges from around the world. The goal of the Eurasian Group is to provide a platform for cooperation and sharing experiences, promoting principles and institutional reforms to encourage the development of regional stock markets.

The year was also marked by the signing of a number of memoranda of cooperation. From the point of view of recognition of the country's stock market on the international arena, the shares of three Kazakh issuers included in the Dow Jones FEAS Titans 50 basket were a significant event. These were ordinary shares of Halyk Savings Bank of Kazakhstan JSC, Kazkommertsbank JSC and KazMunayGas Exploration Production JSC, whose weights in the index basket at the beginning of August 2011 were 2.07%, 1.85% and 1.91%, respectively.

*Summing up the year 2011, KASE President **Kadyrzhan Damitov** highlighted that the Exchange had learned some lessons from the crisis. The Exchange President promised: "In 2012–2013, continuing to progressively implement the Strategic Plan, we will focus on marketing activities and try to reverse the trend of falling stock exchange turnover in the securities market. And although not everything here depends on KASE, we believe that we will achieve a certain success."¹⁵*

With this, we started 2012 – the year when the People's IPO began.

TASKED WITH RISK MITIGATION

On the first days of the new 2012, the Prime Minister of Kazakhstan, Karim Massimov, said that the republic's GDP had grown by 7.5% in the previous year, although initially 7% had been expected. The National Bank supported the positive news by stating the expected growth of the republic's GDP in the coming year at 6%. The Chairperson of the National Bank of Kazakhstan, Grigoriy Marchenko,

clarified that the economic growth “will depend on the scenarios that will develop in the market.” The financial regulator also kept the expected medium-term inflation rate in the range of 6–8%.

The current account surplus in 2011 was USD 13.6 billion with an increase of almost 4.5 times over the year. But the budget had a deficit of KZT 568.6 billion. The Ministry of Finance actively borrowed from the market through the sale of government securities, and as of January 1, 2012, the volume of government debt in circulation, including short-term notes of the Kazakh National Bank, was KZT 2,590 billion at a discounted price.

At the beginning of 2012, the financial regulator took another step, emphasizing the prevalence of positive trends in the financial market: on February 14, the official refinancing rate of the Kazakh National Bank was reduced to its historic minimum of 7%. In fact, the economy was recovering from a recession. Lending activity was also observed: after a decline of 0.7% in 2010, bank lending to the economy increased by 15.7% in 2011. This was the overall picture at the start of the year, which actually demonstrated the return of the financial sector and the economy back to the ordinary pace.

The new year began with the search for solutions to the recurrent problems of the financial market. The announcement of a possible compromise on restructuring the debt of BTA Bank JSC was an important event of the first days of January. Everyone hoped for the successful completion of this banking “saga”, which had a negative effect on the image of both the banking system and the entire country. There were long negotiations, but in October it was announced that the bank and most members of the creditor committee agreed upon the main terms and conditions for the restructuring of BTA Bank’s debts in the amount of USD 11.1 billion. As a result, its financial debt was reduced to USD 3.3 billion.

And there were a few more important events of the year directly related to KASE: the development and adoption by the country’s government of the Roadmap on the Development of Islamic Finance until 2020; the plan of a debut issue of sukuk al-Murabaha with a double listing on the domestic stock exchange and the Malaysian stock exchange announced by the Development Bank of Kazakhstan. It was stated that the volume of the first issue would be USD 200–300 million with a term of at least 5 years. And the total amount of the program was planned to increase to USD 500 million.

For the Purpose of Crisis Prevention

Despite the recovery process in the economy, the state was concerned about the problem, if not about risk prevention, then at least risk mitigation, with the search for preventive measures. Therefore, in 2012, major changes were made to the current legislation regulating the financial market. Many market players now believe that these measures had the greatest impact on the image of Kazakhstan’s financial and especially stock market in the 21st century.

The Risk Mitigation Law¹⁶ changed the requirements for the activities of almost each of the parties in the issuer – investor and borrower – lender chains. For example, additional requirements were introduced for issuers issuing debt securities; the violation of such requirements obliged the issuer to repurchase bonds from their holders. Such requirements included, but not limited to the bans on changing the main line of activities and the legal form, as well as on the alienation of large shares of assets.

Financial companies – members of the Exchange – had to become much more open: as joint-stock companies, they were supposed to disclose financial statements and information concerning the most important events via the websites of the Financial Reporting Depository; as members of the Exchange, they were supposed to provide the Exchange monitoring service with the same statements and information.

The Law also obliged private APFs to undergo a listing procedure on the Exchange. During the year, shares of ten out of the eleven APFs operating at that time were included in the KASE official list, which was a positive event for fund members, since the securities on the KASE official list were associated with very strict disclosure requirements for their issuers.

Risk Mitigation Law and Stock Market

On February 1, 2012, most of the clauses of the *Law On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on Regulating Banking Activities and Financial Organizations in Risk Mitigation* (the Risk Mitigation Law) came into effect, in accordance with which certain amendments were introduced to the Civil and Criminal Codes, the laws *On the Securities Market*, *On Joint-Stock Companies*, *On Banks and Banking Activities in the Republic of Kazakhstan*, *On Pension Security in the Republic of Kazakhstan*, *On Investment Funds* and a number of other legislative acts.

The most important innovations related to the securities market were:

- establishment of the Single Registrar and the Bad Loan Fund;
- a ban on listed bonds in the unorganized securities market;
- a requirement for the mandatory presence of a representative of bond holders;
- issuer's obligations to fulfill covenants and redeem bonds upon the occurrence of certain events (failure to meet certain conditions);
- toughened requirements for the issue and/or placement of securities of an organization – resident of the Republic of Kazakhstan in a foreign state and listing of such securities on a foreign stock exchange, as well as sanctions for non-compliance with these requirements;
- a decision made by the executive body of the Exchange on securities listing under a simplified procedure;
- a requirement for mandatory presence of APF shares in the KASE listing; and
- a requirement for mandatory publication of financial statements and audit reports, and information on corporate events on the websites of the Financial Reporting Depository of the Stock Exchange.

Brokerage companies had to undergo a very painful transformation, for which almost unprecedented global minimum capital requirements of 400,000 MCI were introduced. This resulted in a decrease in the number of brokerage companies. Then, in accordance with the requirements of the financial regulator, brokers were divided into two categories: the first one – with the right to maintain accounts of nominal holding, and the second ones – without such a right. These changes put additional pressure on the profitability of individual companies in the stock market. As a result of these and other measures of the regulator, the number of KASE stock market members decreased from 74 to 60 for the year.

The “rules of the game” changed for the Exchange itself as the organizer of trading. During the year, KASE employees and management did a great job in bringing the internal documents and business processes in line with the Risk Mitigation Law. In particular, a new business unit was established – the Clearing House, which was mainly responsible for the direct performance of all clearing procedures, and on July 19, 2012, the Exchange received a license for clearing activities in the securities market No. 4.2.3/1 issued by FSC of the Kazakh National Bank.

The responsibility of KASE in terms of monitoring of financial stability and solvency of issuers and members of the Exchange, control over insider activities increased drastically.

According to **Yelena Bakhmutova**, “The regulator tried to “civilize” the market. Perhaps, they went too far in some cases, and those companies that decided this was too hard for them, have just withdrawn into the shadows. They tried to take loans from banks, not from the stock market; the largest ones have entered foreign exchanges. We have seen liquidity going to foreign exchanges; we tried to force such issuers to place at least some of the stakes inside the country. We understood that this would not save the local market, but at least it would give some impetus. By the way, entrance of domestic companies to the foreign markets has also encouraged progressive changes in legislation. And the fact that the securities were placed simultaneously in both the foreign and domestic markets contributed to the introduction of the best standards and practices of foreign stock exchanges in the domestic market.”

For its part, the Exchange tried to find a balance between the regulatory burden and the needs of market players. For example, to ease listed companies’ liabilities on information disclosure to KASE, the is2in system¹⁷ was developed and introduced.

According to KASE Vice-President **Natalya Khoroshevskaya**, “At the time of launch, the system was designed to provide electronic document flow between the Exchange and listed companies in the process of information disclosure. Later, it was used to disclose information by members of the

Exchange. This system made it possible to abandon exchanging documents on paper. In addition, the disclosure of documents in electronic form is more convenient to control their quality and allows significant reduction of the period from the receipt of a document by the Exchange to its disclosure via the website.¹⁸

And the whole history of the Kazakhstan Stock Exchange is full of such examples of searching for compromises.

Firstborn of the People's IPO

The second event in the stock market in 2012, which was essential not only to KASE, but also to the whole country, was the launch of the state program – the People's IPO. The key task of its implementation set before KASE was to play the role of the technical organizer of the subscription for the shares of the first member of the program – KazTransOil JSC – in a mode completely new to the Exchange.

*Kazkommerts Securities then headed by **Sholpan Ainabayeva** and the winner of the tender was chosen the Kazakh financial advisor of NWF Samruk-Kazyna on the People's IPO program. "A tremendous job was done to determine the investment attractiveness and readiness of the Fund's subsidiaries to IPO, to determine the sequence of their IPOs, to determine phases of an educational program for the population while preparing the program; the work on making necessary amendments to the laws and the relations was started. In my opinion, the Government's initiative to form a class of private investors from the population was rather useful and socially significant. Despite the fact that later the program was closed, its role in raising the population's interest in the stock market was essential", Sholpan Ainabayeva recalls. "The People's IPO differed from a classical IPO in that easy-to-understand and socially just mechanisms for distribution of shares to all types of individuals had to be developed. Technical systems for simultaneous servicing of significant number of investors had to be prepared and a large-scale roadshow across regions had to be conducted. As a result, approximately 120 meetings were held in the different regions. This part of work could not be done by foreign consultants and it fell on the shoulders of the Kazakh side. An elegant solution was found on the collection of orders and conducting large-scale one-time settlements, i.e. to use the trading system of Kazakhstan Stock Exchange, which in itself was an innovation, because in a classical IPO, an order book is maintained by a consortium of consultants and an issuer makes settlements with each shareholder directly through the registrar. The decision to do this through the Exchange has significantly simplified the work of brokers and the issuer and has made the process easy and transparent."*

The road show of KazTransOil JSC covered all regions of the country. The dynamics of interest appeared immediately. For example, in November, during meetings with potential investors in Almaty, Umirzak Shukeyev, who was the Chairperson of the Management Board of Samruk-Kazyna NWF JSC at that time, said that since the opening of the subscription, following the results of its first day, the total amount of requests for the company's shares had amounted to KZT 184.4 billion. By November, over 26,000 personal accounts of retail investors were registered, whereas for all the years of the domestic stock market there had been less than 10,000 of such accounts before. Moreover, at the time of completion of the subscription, the number of open accounts reached 52,000.

Twenty-two brokerage companies and ten APFs took part in the formation of the book of requests for the purchase of shares of KazTransOil JSC. Total demand exceeded supply by more than twice and amounted to KZT 59.4 billion. According to the results of the subscription, 100% of the requests of individuals within the maximum allowable amount per person (KZT 7 million) were satisfied. The volume of unsatisfied demand on the requests exceeding the 7-million limit was KZT 71.6 billion. The final distribution of shares was as follows: shares worth over KZT 22 billion were acquired by individuals, APFs purchased securities for KZT 5.7 billion, and the market maker bought shares worth KZT 157 million in order to fulfill its obligations to maintain liquidity.

On December 25, 2012, KASE opened secondary trades in ordinary shares of KazTransOil JSC. For a week of trading, the price for the securities increased to KZT 837 per share, which was 14% higher than the placement price (KZT 725). Many players, including pension funds, while expecting further price growth, increased their positions in excess of the volume acquired during subscription. The shares of KazTransOil JSC became one of most marketable securities on KASE. For all subsequent years, the issuer of shares paid large dividends to its shareholders, thus confirming that the choice of a pilot company for the People's IPO was right. As at mid-November 2018, the price of one KazTransOil share was around KZT 1,330 and only in 2015 it fell below the IPO placement price for a short period for several times.

The successful placement of shares of KazTransOil JSC was due to the holding of unprecedented events for the entire infrastructure of the stock market of Kazakhstan. For KASE, this was a unique chance to improve operational activity to a qualitatively new level and prepare its infrastructure for further development and subsequent placements of companies. And the Exchange successfully coped with this challenge – for the entire period of the subscription at KASE, not a single technical or operational failure occurred.

At the end of the year, in addition to the placement of KazTransOil JSC, an IPO of the mobile operator Kcell JSC was held at KASE, which gave the market another interesting investment tool. This was preceded by the sale by the national telecom operator Kazakhtelecom JSC of its stake in Kazakhtelecom OJSC GSM Kazakhstan LLP. In the first quarter of 2012, this 49% stake was acquired by the European telecommunications holding TeliaSonera A.B. for USD 1,519 billion. After completion

of the transaction, Kazakhtelecom OJSC GSM Kazakhstan LLP was reorganized into Kcell JSC for the subsequent sale of up to 25% of ordinary shares through initial offering on the Kazakhstan and London Stock Exchanges.

Shares of Kcell JSC were included in the official list of the Exchange in the first category on November 29, 2012. Simultaneously with listing of ordinary shares of Kcell JSC on KASE, global depository receipts were listed on the London Stock Exchange with ordinary shares of Kcell JSC as a basic asset. The price range for the company's shares was set between \$10.5 and \$13.0 for global depository receipts, and the value of ordinary shares at the beginning of trading was KZT 1,578.68 per share. In the course of the subscription and specialized trades in ordinary shares of Kcell JSC, KASE managed to attract KZT 7.5 billion (9.44% of the total offering) in the exchange market.

GDR of the Kazakh mobile operator were also accepted with a great interest on the London platform, where their cost increased from initial \$10.5 to \$11.24 per receipt for just one day. As a result, Kcell won the Best IPO in Central and Eastern Europe in 2012 according to EMEA Finance magazine, and was awarded for the best depository receipts program.

The IPO doublet of private and quasi-public companies on KASE was a significant support for the Kazakhstan stock exchange market. The securities of Kcell JSC and KazTransOil JSC were included in the representative list of the KASE Index, thereby improving its representativeness.

In 2012, new instruments appeared in the non-government debt sector. Bonds of an international financial organization, the Eurasian Development Bank, were placed on the Exchange. The debut issue of Islamic securities of the Kazakh issuer –



The ceremony of official opening of trading in ordinary shares of KazTransOil JSC in the KASE secondary market, 2012

THE PEOPLE'S IPO PROGRAM

The Program for the Placement of Stock of Subsidiaries and Affiliates of Samruk-Kazyna National Welfare Fund Joint-Stock Company on the Securities Market (or simply, the People's IPO Program) was approved by Government Resolution No.1027 of September 8, 2011. The Program's goal was to ensure an opportunity for the citizens of the Republic of Kazakhstan to purchase shares of leading domestic companies and promote the development of the Kazakhstan securities market. The target indicators of the Program included: placement of shares of six subsidiaries and affiliates of Samruk-Kazyna Fund as part of the People's IPO; involvement of at least 160,000 individuals, citizens of Kazakhstan, in the Program; the growth of the stock market capitalization rate of the Kazakhstan Stock Exchange by at least 5–20 % by 2015 from the average for 2011; attracting no less than USD 500 million as part of the placement of shares of the Fund's companies until 2015.

The list of candidate companies for initial offering was divided into three trains according to the degree of readiness for IPO: train I (Q2–Q3 2012) included KazTransOil JSC, KEGOC JSC and Air Astana JSC; train II (2013) – KazTransGas JSC, Kazmortransflot NMSC JSC and Samruk-Energo JSC; train III (2014–2015) – Kazakhstan Temir Zholy NC JSC and Kaztemirtrans JSC. In addition, after 2015, companies with a high risk of share volatility, such as KazMunayGas NC JSC, Kazatomprom NAC JSC and other producer companies, should have started IPO.

At the first stage, preference was given to so-called tariff companies, whose performance depended directly on the tariffs set by the state. Their activities were the least exposed to market risks, and therefore it was decided to sell the shares of such companies to the public. A typical representative of this group was KazTransOil JSC – the state monopolist in oil transportation. The Program began with this company in the fall of 2012. The first experience demonstrated a number of positive effects from the People's IPO:

- increased number of retail investors in the KASE stock market – 34,000 people took part in the placement of shares of KazTransOil JSC;
- an opportunity for the public to invest in stable companies and the real sector of the Kazakh economy with the corresponding expectations for dividend payments and growth in the market value of securities;
- better transparency of state-owned companies placing shares in the organized market through complete disclosure of information concerning their activities by listing on KASE and further when operating as listed companies;
- gaining experience in bringing state-owned companies to the stock market as a positive factor for the subsequent placement of securities of Kazakh companies in the public and private sectors;
- practical formation of an investment culture among the population and raising financial literacy;
- an additional tool for diversifying people's savings; and
- an improved role of the retail segment in the business practices of financial companies-members of the stock market.

The process of preparation of the following candidates for IPO took longer than expected, and the next placement of the power company KEGOC JSC took place only at the end of 2014. In addition, the deterioration of the macroeconomic situation and high devaluation expectations had negative influence. As a result, in the fourth quarter of 2014, the target indicators of the Program were changed, and the deadlines for its implementation were extended until 2022. In 2016, due to the approval of the Comprehensive Privatization Plan for 2016–2020, the People's IPO Program was put on loss.

sukuk al-Murabaha bonds of the Development Bank of Kazakhstan announced at the beginning of the year took place. These securities were placed simultaneously in the markets of Kazakhstan and Malaysia. The share of Kazakhstan investors accounted for 38% of the total offering.

Imbalanced Environment

The overall results of stock trading in 2012 were disappointing. The trade volume decreased by 6.7% compared to 2011, and by 8.3% in terms of US dollars. The imbalanced structure of trades by sectors reiterated: the growth of the activity of exchange trading in shares (+28.4%) and corporate bonds (+6.4%) was easily derailed by negative dynamics in the segments of foreign currencies and repo transactions, which accounted for 52.1% and 41.3% of the total exchange turnover, respectively.

The reason for the fall in volumes in the currency market was the decline in the KZT to USD exchange rate fluctuations and the reduced share of the National Bank's interventions. Second-tier banks were traditionally active. As a result, the trading turnover in the sector in 2012 amounted to KZT 14.3 trillion (including 65% in spots, 35% in swaps), which was lower than the previous year: KZT 15.6 trillion (76% in spots, 24% in swaps). The KZT to USD exchange rate weakened by 1.58%. And the last transaction of the year in the main currency session was made at KZT 150.80.

The money market experienced certain turbulence. The overnight rates in certain periods exceeded 20% per annum. The auto repo segment with government securities was subject to a decrease in activity of the major players. And if the maximum volume of repo transactions for a month reached KZT 1.5 trillion in 2011, then the same value did not exceed KZT 1.2 trillion in 2012. The KazPrime-3M Indicator (KZT) reflecting the value of interbank three-month deposits increased from 2 to 4% per annum, and the indicators of the value of shorter money – TWINA and TONIA – increased from 1.10 to 2.70% per annum and from 0.94 to 1.55% per annum, respectively.

In the stock market, the environment was developed, first of all, under the influence of local factors, and in spite of the increase in trade turnover, Kazakh shares mainly fell in price.

Two positive spikes were observed when the "extraordinary dividend" was paid on the shares of Kazakhtelecom JSC related to the sale of the company's interest in GSM Kazakhstan LLP. The second period was at the end of the year when trading in ordinary shares of KazTransOil JSC and Kcell JSC opened in the secondary market of KASE. As a result, the December turnover in this sector increased more than 17 times compared to November!

In total, the KASE Index decreased by 12.3% by the end of the year. A weak diversification of the representative list of the Index was again the reason for this. The "leaders" of the fall were ordinary shares of Eurasian Natural Resources Corporation Plc (-52.6%), Kazakhtelecom JSC (-32.9%) and Kazkommertsbank JSC

(-31.6%). The growth in 2012 was demonstrated by ordinary shares of KazMunayGas Exploration Production JSC and Halyk Savings Bank of Kazakhstan JSC – 18.5% and 41.3%, respectively. The total capitalization of the stock market at the end of the year was USD 37.9 billion, with a 12.5% decrease.

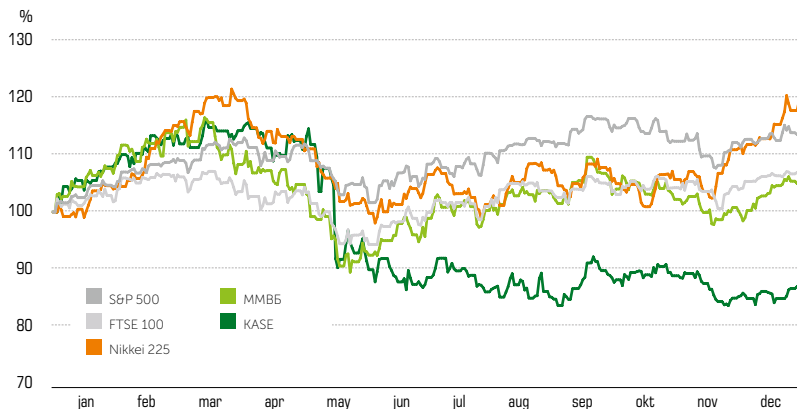
In the third quarter of the year, there was a change in the rules regulating the GS primary market. The Resolution of the Management Board of the Kazakh National Bank of July 15 assigned the right to buy treasury bonds of the Ministry of Finance in the exchange market to APFs, PAMCs, STBs and insurance companies operating in life insurance. Brokerage companies and their clients were cut off from this segment. FSC explained such a decision by the need to prevent the manipulative transactions, strengthen control over the use and dissemination of insider information, and level the capital adequacy risks to secure requests of participants in primary trading.

At the same time, the volume of the exchange placement of treasury bonds in 2012 reached a historic maximum of KZT 1.1 trillion, with an increase of 58% compared to the previous year. In the fourth quarter of 2012, the Ministry of Finance attracted over KZT 409 billion. The total face value of GS circulating increased by 18.8% to KZT 3.1 trillion over the year.

With existing low segment activity caused by the reform of the pension system, liquidity in the secondary market for government bonds got under additional pressure. The volume of transactions in the secondary GS market was halved to KZT 230.1 billion.

The corporate bond market was also subject to regulatory changes, but with a positive effect. In particular, the ban on over-the-counter placement of listed bonds was introduced. As a result, by the end of the year, the volume of corporate bond trading at KASE increased by KZT 18.7 billion (+6.4%) and amounted to KZT 313.2 billion, which was the highest value over the past three

CHANGES IN MAJOR STOCK INDICES IN 2012



years. The capitalization of the corporate bond market decreased by 21.4% to USD 31.5 billion for the year.

Generally, a contradictory picture was observed in the market throughout the year. According to analysts of the Exchange, this was a consequence of the general market conditions, a reflection of economic indicators, operational risks of public companies, and specific risk factors of Kazakhstan, such as, e.g. changes in regulation and low activity of professional players.

* * *

The period from 2010 to 2012 became the time for learning lessons both for market participants and for regulators. Given the fact that Kazakhstan is embedded in the global market, no one could say with confidence whether all 'arrows' of the 2008 year of crisis have already been fired. Even when it seemed that the crisis cycle was behind. In this situation, the determination to improve risk management, to modernize processes and to cut costs was probably the only justifiable course of actions. This was the set of accomplishments with which the Exchange has stepped into the 13th year of the new millennium.

EXCHANGE SIMULATOR PROJECT

The Exchange Simulator training competition was officially launched by the IRBIS Financial Markets Information Agency on July 29, 2008 pursuant to the agreement signed between the Agency, KASE and the Kazakh-British Technical University (KBTU). The first simulated trades were held in 2008, in two stages, among 49 students of KBTU and the Kazakhstan Institute of Management, Economics and Forecasting (KIMEP). The technologies of that time did not allow holding trades remotely, therefore they were held on the KASE trade floor. The winners received certificates and a chance to have volunteer internship at KASE.

In the fall of 2011, it became possible to hold trading remotely through the STrade trading terminal. This made it possible to expand the number of participants in the Exchange Simulator to 29 teams of 145 students from 5 universities. Later, the contest format changed to an individual one, the first prizes appeared: the winner was presented with an e-book reader.

In spring 2012, a prize fund of KZT 350,000 (team and individual nominations) was drawn. This practice was further used, as well. In addition to money, the project partners and sponsors provided alternative awards for the best participants.

In 2017, as part of the competition, it became possible to make transactions using a smartphone. In 2018, together with financial companies – project partners, it was decided to award the winners of the competition with a guaranteed paid internship, which made it possible to expand the list of winners.

In total, over 10 years of the project's existence, more than 5,700 students from 80 universities of Kazakhstan, and students from Turkey, South-East Asia and the United Kingdom have participated in simulated trades. In 2017, 1,509 students registered for the games, and 1,290 in 2018. The total prize fund for 10 years exceeded KZT 5 million.



KASE HEADQUARTERS

There were several official addresses in the history of KASE. The Exchange received the first of them in 1993, by renting the first floor of a residential building in 37a Satpayev Street. The largest room was occupied by the trading floor; from this room one could get into the programmer's office. The structure of the Exchange also included the Trading Department, Clearing House, Analysis Department, Legal Department and Accounting Department.

In September 1994, the Exchange moved to the 6th floor of the Ministry of Motor Roads located at 86 Gogol Street (currently, Kazzhol Business Center). The trading floor was arranged in the corridor of an open lobby and in the large conference room, where the Exchange Council meetings were held, they started collecting books for a library.

In summer 1996, the Exchange moved to the building of the National Bank of the Republic of Kazakhstan, at 21 Koktem 3 Microdistrict. There was the first trading floor with the tables with partitions with a separate computer and telephone for each trading participant. There were brokers' workplaces on a separate stage, while the Information and Analysis Department was located in the last aisle of the trading floor.

In March 1998, the Exchange moved to NSC at 67 Aйтеке Би. The office was located

on the first floor, where the Supreme Court had previously had sessions, and the trading floor was arranged in the former cinema. Well-coordinated actions of the employees of the Exchange, including all members of the Management Board, made it possible to transport and install all the main trading equipment, install and arrange the local network and fully equip the server room for just three days at the weekend. As a result, trading in the new premises was continued without affecting the daily schedule of the sessions.

On July 2, 2007, a part of the Exchange (Management Board, Legal Department, Listing Department, Information and Analysis Department, Front Office) moved to a new building at 291/3 Dostyk Avenue. The Accounting Department, Clearing House, Trading Department, Software Department stayed at 67 Aйтеке би. So, the Exchange members started using terms "upper office" and "lower office" in the best traditions of Almaty. The building of the upper office was built according to the Italian project and was very beautiful. It was called the Red House because of its color.

Since November 14, 2011, the main office of the Exchange with a total area of more than 3,000 m² has been officially located in the North Almaty Tower at 280 Bayzakov Street.





中國銀行
BANK OF CHINA

KASE



KASE

Ring the Bell
for Gender Equality



Chapter 6

TIME OF CHALLENGES AND TRANSFORMATIONS

ON THE WAY TOWARD A NEW MONETARY POLICY
PENSION SYSTEM REFORM: ONE INSTEAD OF MANY
PEOPLE'S IPO: LIFE AFTER START
FOUR IMPORTANT STEPS TO BOOST LIQUIDITY
CHANGING LEGISLATION
IN PURSUANCE OF INTERNATIONAL STANDARDS

Chapter 6.

TIME OF CHALLENGES AND TRANSFORMATIONS

The period of 2013–2015 became a time of challenges and transformations both for KASE and the whole financial market of Kazakhstan. Transition to a new monetary policy, refusal from the fixed rate of exchange of national currency, reorganization of pension system and, therefore, change of investor structure, external shocks at primary commodity markets and deterioration of geo-economical situation. All this required a flexible adaptation to a new reality, full mobilization of accumulated experience and resources, receiving new competencies and search for non-standard solutions. Even in these complicated conditions the stock exchange not only stayed afloat but achieved new records and gained victories.

ON THE WAY TOWARD A NEW MONETARY POLICY

The beginning of 2013 looked encouraging. Although the development of economy of Kazakhstan as compared to 2010 and 2011 has become significantly slower – GDP growth was 4.8% as compared to 7.3% and 7.4% respectively, but the inflation has not just remained within the planned corridor (6–8%), but remained at its lower limit – 6%. Low market rates made for development of the real sector as since August 6, 2012 the official NBRK refinancing rate had been established at a historic low – 5.5%. One of business activity growth factors in 2012 was extension of the cumulative demand in economy connected with increase of credit activity of banking sector and increase in monetary income of population. In general the volume of loans of banks increased 13% to KZT 9 958 billion (USD 66.3 billion).

Further development of financial sector required the more effective liquidity regulation. Instruments of the National Bank in this field were rather limited; for liquidity taking they have issued short-term notes and attracted deposits, and for its provision they have used refinancing loans and repo transactions. In connection therewith the regulator started introducing changes into the monetary policy system. As early as in 2012 foreign currency cash and correspondent accounts have been removed from the reserve asset structure of second-tier banks; and the main promising direction for 2013 was the staged implementation of a new transmission

mechanism. At the first stage, within the pilot project National Bank's transactions in automatic repo sector were resumed at KASE, which had been suspended in 2005. This, by the way, enhanced the role of Kazakh stock exchange in general development of economy of the country.

With a view to make a yield curve the National Bank together with the Ministry of Finance have decided to work on increasing of the liquidity of state securities, yield of which would have to become a benchmark at the financial market for instruments with similar terms. Besides, the financial regulator continued building its portfolio of long-term government securities having purchased them from participants at the secondary market; and the regulator was going to include auctions to buy-sell back securities in the battery of its open market transactions.

NBRK interest rate collar has changed too: it was stated that the main target in interest policy implementation would be the rates at the financial market. Moreover, as long ago as 2013 the regulator has shown a new target as a perspective in implementation of the interest policy – the basic rate with tolerance limits, which was supposed to be calculated based on 7 days transaction. All these innovations must have activated the credit channel of the transmission mechanism of monetary policy and reduced the importance of the foreign currency channel.

As they have reckoned in the National Bank, this would contribute not only to reduction of economy dollarization, interest rate volatility and speculative component at the financial market, but also to increase of flexibility and efficiency of liquidity regulation as a consequence.

Grigoriy Marchenko, head of the National Bank, representing the plans of the Bank on March 19, 2013 during the traditional online conference has stated^d that at the foreign currency market "the KZT controlled float mode is going to be maintained with minimum interference of the National Bank. That said, the volume of currency interventions carried out by the National Bank will be decreased to the extent that the transmission mechanism of monetary policy develops. Thus, the regulator's influence on currency market behaviour will be minimized".

Curbing Rumours

However, the reality was more complicated. At the beginning of summer 2013 the devaluation subject significantly activated in Kazakhstan. Though specialists tried to convince the public otherwise speaking about the absence of fundamental factors (prices for Kazakh raw materials kept on relatively high levels), the market was set in nervous motion. During 24 days in July the market rate of KZT to USD decreased from 151.65 to 153.17. It was exceptional at that time. Analysts have connected it with weakening of the ruble that has devalued 8% from the beginning of the year, and with exhaustion of competitiveness potential of tenge, which was provided by previous 25% quotation price adjustment in 2009.

Verbal interventions came into play: in spite of the “dead” season in business activities the head of the National Bank, Grigoriy Marchenko, has stated at the beginning of August: “There are neither internal nor external reasons for devaluation at the moment. After the devaluation of February 4, 2009 such waves and rumour appeared 19 times,” the banker counted. “We have more than enough resources, and no one plans or is going to carry out any sudden, slumping devaluation.”²

Starting from August 6, a consistent trend of growth of exchange rate of tenge to US dollar emerged, within 20 days the national currency has strengthened 1.1%. But it already was not satisfactory for the market. Here the regulator’s “hand” could be clearly noticed, – only in July the National Bank has sold USD 2.65 billion of their assets³ to support tenge. And disquieting apprehensions have strengthened at the currency market. A sudden and significant deterioration of external payments position according to results of the second and third quarters of 2013 has strengthened the devaluation stress and growth of economy dollarization.

On September 2, the regulator has declared a transition to the use of tenge’s peg to a multi-currency basket consisting of USD (70%), Euro (20%), and Russian ruble (10%), which was supposed to slowly decrease the role of American currency at the internal market and in international economic activities through reduction of speculative sentiments at the market.

In October Kairat Kelimbetov has become the head of the National Bank instead of Grigoriy Marchenko. Substantially immediately he had to make an official statement on continuation of the monetary policy, absence of objective prerequisites for its change, and stability of the situation at the currency market.

But, apparently, the market was not hooked by their rhetoric. For instance, one- and two-day swap transactions were actively carried out at KASE, especially in the second half of 2013, as banks preferred not to shorten their currency position even in relatively high demand for tenge. The volume of currency swap opening transactions achieved KZT 9 trillion (USD 61.6 billion) having demonstrated 80.7% growth as compared to 2012, while the spot-market increased only 0.2%. In 2013 the demand of banks for transactions on KZT liquidity taking (issuing of short-term notes and attracting deposits) was slowly decreasing. The volume of notes in circulation in December 2013 as compared to December 2012 decreased 52 times to KZT 3.6 billion. Along with that a reduction of government securities market was noticed, the traded value at the primary market reduced 8% to KZT 982.5 billion within the year. At the secondary market the liquidity decreased much faster: here the traded value did not exceed KZT 191.5 billion, having shown a 16.8% drop as compared to 2012.

KZT instruments were not among ordinary Kazakhs’ favourites too; the volume of net purchases of currency by the population in 2013 was KZT 2.199 trillion, and the proportion of deposits in foreign currency increased from 29.8% to 37.4%. KZT exchange rate was supported with significant interventions carried out by the National Bank, which caused a serious reduction in its gold and forex reserves in 2013: 12.6% to USD 24.7 billion.

When presenting their rather positive forecast of development of economy of countries of Caucasus and Central Asia, IMF analysts have emphasized that the factor aggravating vulnerability of financial sector of Kazakhstan was the wide-spread dollarization, which “not only weakens the influence transfer mechanism of the monetary policy, but also causes vulnerability of the banking system in case of probable wild foreign-exchange fluctuations”⁴.

Exchange Rate and Commodity Shocks

That being said the year of 2013 was successful in general for the economy. GDP of Kazakhstan has increased 6% in real terms, banking sector assets increased 11.4% to KZT 15.5 trillion, and retirement savings increased 17.3% to KZT 3.7 trillion. The inflation has reached its minimum since 1999 that was 4.8% per annum. But dollarization (de-facto signaling of devaluation expectations), against which the National Bank had “knocked” in implementation of the monetary policy in 2013, continued growing in the beginning of 2014. The official US dollar rate as of the end of January was KZT 155.5 per dollar that fixed 0.9% KZT weakening during a month, in spite of ongoing interventions of the regulator (net sales amounting to USD 1.9 billion)⁵. Considering that at preceding year end the current account deficit has already been formed at the level of USD 117.8 million (against a surplus equal to USD 1.1 billion in 2012), the regulator has given up, and KZT devaluation, inevitableness of which had been actively discussed during the second half of the preceding year and the entire January 2014, has materialised nevertheless.

On February 11, 2014, the National Bank has announced its decision to refuse from maintaining KZT exchange rate at the previous level, to decrease currency intervention amounts, and to reduce interference with the process of its build-up. “The National Bank assumes the new exchange rate level would be about 185 tenge for US dollar,”⁶ the official NBRK statement stipulated. Among reasons and motivations of its decision NBRK mentioned high devaluation expectations in Kazakhstan economy and strengthening of speculative transactions, uncertainty about the exchange rate of Russian ruble, as well as planned transition to inflation targeting.

*Head of the National Bank, **Kairat Kelimbetov**, has reported during a press-conference carried out on the devaluation day: “In future exchange rate can be changed both towards weakening and strengthening, which would be defined by the situation in global economy. It means that the rate is going to fluctuate between 182 and 188 tenge within the year. In other words, KZT rate is going both to decrease and increase, in case of good results in economy. For this reason I would admonish stock jobbers of drawing any firm conclusions. We are going to support this rate.”⁷*

The National Bank has established the band of KZT exchange rate to US dollar from the new level of KZT 185 for USD 1 plus/minus KZT 3, and continued the policy

of smoothing of dramatical rises and falls and short-term volatility of exchange rate. Besides, the fluctuation band for exchange rate in case of foreign currency purchasing and selling for KZT has been established for transactions carried out through exchange offices: for USD – KZT 2, for Euro – KZT 3.

The regulator thought that the potential of speculative devaluation expectations was exhausted, and the National Bank could concentrate on credit interest-rate policy building. In its turn, the exchange market took an active part in developing of monetary policy instruments. The line of exchange indicators was updated and extended in 2014. Corporate bonds indices have been changed as related to their calculation algorithm and criteria of generation of the representational list. Besides, upon request of the National Bank indicators of profitability of foreign currency swap transactions and MM Index (money market index) – short-term money exchange indicator, that is the weighted average value of interest rates (profitability) for one-day transactions of USD/KZT currency swap and automatic repo "overnight" transactions with government securities, have been launched.

By April, the government and the National Bank could together rein in the inflation caused by KZT exchange rate adjustment, and at the year end it was 7.4%, which corresponded to the target corridor of 6–8%. But perhaps it was the only achievement of the monetary policy in 2014. Already in the second half of the year external factors have again placed on the agenda questions about provision of stability of financial system, struggle with dollarization, and protection of the currency exchange rate.

Introduction of sanctions against Russia, Kazakhstan's largest trade partner and a member of the Customs Union and the Common Economic Space, led to heightened volatility of the ruble's exchange rate and to deterioration of the situation in the Russian economy. The effect of this factor was intensified by a sharp and large-scale plunge in global oil prices that reached 50% according to the year-end results. In November the Central Bank of Russia has refused from carrying out currency interventions and announced a transition to inflation targeting, which caused a 60% impairment of ruble to US dollar.

Expectations of the population and business of Kazakhstan of another one-time "adjustment" have roared ahead. People and organizations started converting their deposits from tenge to US dollars. A stream of people poured into Russia willing to buy goods that suddenly became cheap due to the exchange rate difference. All this has increased pressure onto the balance of payments, currency reserves, and, therefore, the fixed KZT exchange rate.

With recession in demand for assets in tenge the monetary base has hit record low. Growth of short-term positions on tenge has caused quickening of liquidity crises where the cost of the most short-term money was expressed in three-figure numbers.

With ongoing dollarization (by the end of 2014 relative weight of KZT deposits in banks has decreased up to 32.5%) 7% reduction in average daily trading volume was noticed at stock-exchange repo market as compared to figures of the previous year, while turnover at the stock-exchange currency swap market increased 67%. This was evidence of the increased availability of US dollar as a security for bank transactions

for drawing of liquidity in national currency. Even the long-term KZT liquidity, that the National Bank has been providing since July 2014 to banks for business loans secured against US dollars through cross currency and interest rate swap transactions, was often used by banks for hedging of risks connected with their obligations and brought to currency market.

As a consequence the foreign currency trading value at KASE nearly doubled during the year, amounting to KZT 33.8 trillion. According to stock-exchange statistics the volume of swap transactions increased 97.2% to KZT 17 744.2 billion, and the volume of spot market increased 70.9% to KZT 16 026 billion.

Negative exchange rate expectations limited the transformation of short-term money into the long-term ones, which finally affected the reduction of banks transactions related to KZT business loans.

Loss of competitiveness of Kazakh exporters, after prices of oil and metals have plummeted with the fixed exchange rate of national currency, caused a reduction in GDP growth up to 4.3% level, which was the lowest figure over the past 5 years. There were no chances that external business environment changes. In March 2015 European Bank of Reconstruction and Development has revised its forecast of Kazakhstan GDP growth in 2015 having reduced it from 5.1% to 1.5%. As it was emphasized in the statement EBRD accounted the whole "severity of risks and a new reality"⁸.

Rubicon Crossed

By early 2015 collapse of confidence in tenge has caused demonetization and aggravated liquidity risks of Kazakh manufacturing plants and business in whole. KZT got "stuck" at the financial market and did not reach the real sector. Those banks, which had access to the liquidity through the purchase of their bonds by UAPF or owing to large government securities portfolio pledged for repo, have provided other banks with tenge through swaps. Such transactions were large, very short, nearly riskless and very profitable ones. For this reason the banks had no any motivation to finance the economy.

The last factor was plausible insomuch that at a meeting carried out in April the Chairman of the Presidium of Atameken RK National Chamber of Entrepreneurs, Timur Kulibayev, asked NBRK: "The National Bank has collected the whole long-term liquidity in the country: you have both UAPF and the National Fund. Its only you who possesses the whole liquidity! Where else the liquidity can be taken from? If the financial system is not launched, all issues we have relating to economy diversification are simply insoluble"⁹.

In connection therewith, at the beginning of the year the National Bank in cooperation with the government have announced the "Plan for reduction of Kazakhstan economy dollarization level for 2015–2016". The plan included three main strategic directions: provision of macroeconomic stability; development of non-cash payments and reduction of shadow turnover; primacy of national currency over foreign currency.

In May, the National Bank has reported the approval of the new monetary policy till 2020, which had been developed in accordance with the instruction of the Head of the state. The new Monetary Policy stipulated the implementation of the inflation targeting mode as the best possible one at the current development stage. In point of fact, they talked about the fact that the exchange rate policy of the National Bank was aimed at the support of the inflation target; and the inflation would have to be reduced to 4% by 2020.

Very few people paid attention to the traditional document though it contained essential directions of the new policy of the National Bank. They came to be understood by the general public only after August 20, 2015, when the regulator announced a transition to a fully flexible exchange rate and introduced a reference rate having increased its importance. The exchange rate band was cancelled. Almost immediately, the official USD exchange rate increased from KZT 188 to 255.26 at KASE. The Kazakh currency has lost ground in a moment; it was down by 26%. Within the following four months the exchange rate was extremely volatile; and KZT has lost more than a half of its cost in dollar terms. In that period more than USD 5 billion have been sold from National Fund's resources and gold and forex reserves of the National Bank; and the regulator's market participation share was 60%¹⁰.

As it was mentioned above, as part of the transition to the inflation targeting mode the National Bank announced introducing of the reference rate – the target value of the targeted short-term rate of financial market selected for achievement of the goal of the monetary policy relating to maintenance of stable prices in the medium term. It was a one-day repo rate, which was established at the level of 12% per annum. It was introduced on September 2, 2015. However, in as little as a month, on October 2, the regulator decided to increase the reference rate to 16% per annum. That said, the rate for provision of liquidity to banks was 17% per annum, and for its taking – 15% per annum. Besides, the National Bank decided to restrict the interest rate corridor to ± 1 pct for reduction of volatility of interest rates of the financial market and provision of clear signals to the market.

But, in order to make the system function to the full extent, first of all it was necessary to regain the trust of population and business to the regulator itself and the financial system, synchronize repo and swap rates, and throw cold water on "hot heads" of currency profiteers and homebred carry traders. That was the task emphasized by the Head of the state in November, when introduced a new Chairman of the National Bank, Daniyar Akishev. One of the first statements made by the National Bank after the arrival of the new head was the announcement on reduction of its participation in the internal currency market for retention of reserves. "Further movements of KZT exchange rate are going to happen under influence of factors mainly defined by cost situation development at global financial and product markets," – the National Bank representatives promised. However the regulator has temporarily went off the obligations declared earlier in respect of maintaining the interest rate corridor within a certain range, having refused to unconditionally provide banks with KZT liquidity, until the day comes when the currency market situation stabilizes.

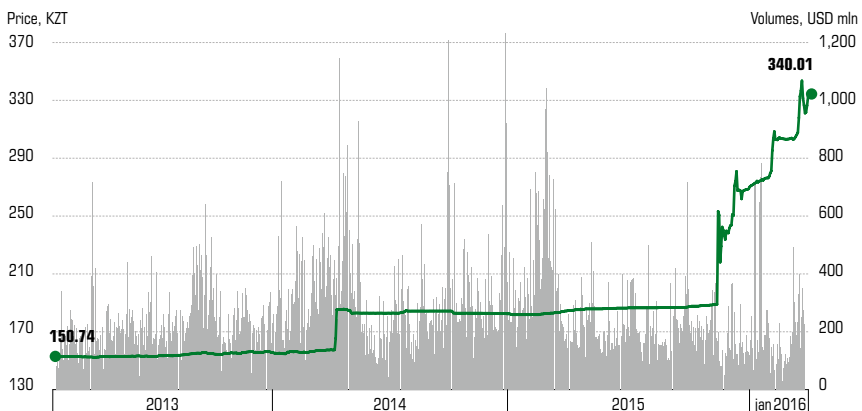
The results of 2015 have shown that the market seemed to have believed the National Bank. According to KASE figures foreign currency traded value has reduced

22.4% from KZT 16 trillion in 2014 to KZT 12.4 trillion, out of which more than 99% were US dollar trading for KZT.

But stabilization of situation at the financial market was a long way off still. Repo transaction volumes of 2015 increased 2.1 times to KZT 23.2 trillion. The main trading volume accrued to repo "overnight" secured against government securities. A part of auto-repo transactions with government securities involved increased to 99.6%, 83.7% of which were "overnight" repo. Full activity at the repo market was registered in October 2015, when the trading volume here exceeded KZT 4 trillion, and the difference between rates in repo and swaps was very big. In the said period there were comparably low and stable rates: TONIA (16.78% per annum) and TWINA (16.86% per annum), which was stipulated by the support of UAPF. But, in the course of reduction of fund's participation, TONIA and TWINA demonstrated a "blasting" volatility, having achieved peak values on December 21: 317.95% per annum and 182.75% per annum respectively. Currency swap transaction volumes increased considerably: from KZT 17.7 trillion in 2014 to KZT 53.8 trillion. Rate of return on one-day swaps reached the record level of 389.8% per annum. A very high spread between rates of one-day currency swap and "overnight" repo in September-November 2015 was remarkable. Repo rates were considerably lower as a rule, and banks able to attract KZT liquidity against government securities were happy to provide it under swaps to other banks, which were not able to get it under repo.

All of this clearly shows that both financial market segments – repo and currency swap – functioned in conditions of critical deficiency of tenge that was replenished by the National Bank and UAPF through provision of liquidity to banks using repo- and swap-transactions. This deficiency was successfully used by several banks for gaining of significant profit working with financial market instruments. The real sector got little or nothing.

DYNAMICS OF USD/KZT EXCHANGE RATE AND USD TRADING VOLUME IN 2013–2015



PENSION SYSTEM REFORM: ONE INSTEAD OF MANY

One more milestone event of 2013–2015 that has seriously changed the alignment of forces at the securities market of Kazakhstan was nationalization of all accumulated pension funds and creation, based on their assets, of a Unified Accumulated Pension Fund. The appropriate instruction has been given by the Head of the state, Nursultan Nazarbayev, on January 23, 2013 in the course of the extended government session; N. Nazarbayev has emphasized that such consolidation controlled by the National Bank would allow managing savings of people more efficiently and safely.

The necessity in reorganizing the pension system and solving the related issues in Kazakhstan has been discussed for some time. In mass media they often discussed low profitability of APF not able to cover the inflation level and, therefore, not providing safe keeping of depositors' savings. That said, it was highlighted that top-managers of certain pension funds set high salaries for themselves, overstated administrative expenditure, and inefficiently administered funds entrusted to them.

This criticism was mainly justified, however, the decision on integration was unexpected for many participants of the accumulated pensions system as its modernization with preservation of private funds had been discussed actively before.

According to the National Bank advantages of the UAPF creation were: first, reduction of operating expenses connected with accounting and keeping of retirement assets, administrative expenses. Therefore, in the unified fund the level of commission fees could be halved at least. Second, elimination of a risk of transactions with affiliated persons that took place in some funds before crisis and caused losses. And third, creation of the UAPF would stop a harmful migration of depositors from one fund to another, which caused the reduction of the system overall efficiency.

Head of NBRK, Grigoriy Marchenko, at a meeting with mass media on February 6, 2013 has stated the key principles of the integration: government guarantees will cover savings in the UAPF; the system of individual retirement accounts will not be changed, and all savings on accounts will be retained. Three options were offered to private funds: reorganization into management companies; reorganization into pension funds working with voluntary pension savings; selling of assets, receiving their money and then – voluntary liquidation and exit from the market.

In his turn, **Kairat Kelimbetov**, Deputy Prime Minister, in the interview to Interfax-Kazakhstan information agency in February 2013 has stated, that the state that eventually bears responsibility before pensioners has predictably decided to tighten the control.

“Currently all pension funds perform business activities with the guarantee of the state regarding profitability assurance. That means, if profitability is negative, it is covered from the budget based on the assurance. It is clear that

some pension funds could “kick up their heels” at public expense. Today we can’t allow that ourselves. That is why we have a double guarantee. The first one is the guarantee of the budget. The second one is that we will have a very tough censor in the National Bank. The Bank is going to be the regulator and work closely with companies managing retirement assets: assess them, select, and revoke licences in case of violations. As a result overall profitability will grow fairly for everyone. As pensioners are not to blame for their APF managers’ carelessness!”¹¹

However, many specialists of financial sector believed (by the way, today, after many years even bureaucrats do not argue with them), that “collapsing” of private APF, the most capital-intensive institutional investors, would become an additional shock for the stock market.

*“The system had provided competitiveness, there were the market and placement alternative. This practice of course had problems in its development, but in general it was positive and progressive... The accumulated pensions system, as distinct from the one UAPF, provides a structure: institutions of issuers, investors, investment mechanisms, and, most importantly, – it encourages competition. As an example the Halyk Bank Group can be mentioned, which always has been taking the lead, both because of its size and in terms of development of the market, its legislative framework. At the moment of nationalization Halyk Bank’s APF share was 33%. According to the external assessment the cost of the fund was USD 500 million to 2 billion. It was the very profitable fund, and as for assets quality – perhaps it was the best one. If Kazakhstan chose to get the accumulated pensions system under control, which was really required, the “minor repairs” only would be enough,” – **Umut Shayakhmetova** believes¹².*

However, the decision has been taken. In April 2013 Mazhilis of Parliament has provided a draft Law *On pension coverage in the Republic of Kazakhstan*¹³, which entered into force on April 2 of the same year, and on July 31 based on Government Decree No. 747 the Unified Accumulated Pension Fund JSC has been created¹⁴.

By the beginning of November the first stage of transfer and acceptance of pension assets from APF Republic, then Otan, and others – on a firm schedule, was completed. In March 2014 pension savings of depositors of Halyk Bank of Kazakhstan APF had been transferred to the UAPF, and trust management of their assets was now performed by the National Bank.

The first year after the start of the pension system reorganization was rather painful both for the system itself and for stock market. Non-governmental pension funds closing up and limiting of their investment activities by the regulator for the view of assets protection against withdrawal by the owners of closing funds caused a drastic reduction of institutional investors base and decrease of their activity at primary and secondary markets of non-government and government securities. Weighted average return of a moderate investment portfolio of all APF from when the limitations have been introduced, from January to December 1, 2013 was only 2.37% as compared to 4% for the similar period in the preceding year.

That said, in order to increase the volumes of business loans and to achieve industrialization objectives it was allowed to the functioning APF and UAPF to buy corporate bonds at the expense of pension assets, which, actually, resulted in growth of issuing activities of banks and quasi-public entities. At the end of 2013 the volume of such bonds placement through specialized trading or in the buy and sell sector of the stock market has hit the record high of KZT 201 billion. At the same time, at the secondary market of corporate bonds the traded value was KZT 110.3 billion, having reduced 38% as compared to 2012. UAPF, being the only pension fund instead of many, was doing well in buying of new bond issues, while there was no one whom it could resell bonds before redemption; besides, there was even no reason to resell them.

New Historical Achievements

Creation of the state mega-fund did not release the pension system from the main problem faced by its private forerunners – persistent deficit of investment instruments with sufficient profitability. In November 2013, during his first press-conference as the Head of the National Bank *Kairat Kelimbetov* has stated that constantly growing UAPF assets were going to be spent for government securities.

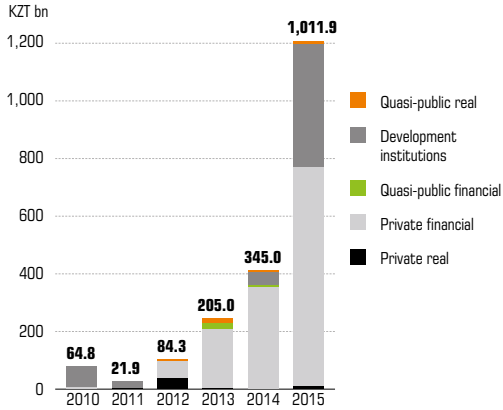
"This is out of the question. It means that 90% are going to be used to finance the budget deficit, to buy government securities. And we are considering a possibility of international investing of a part of money, probably only 10%"¹⁵. The idea was that the Ministry of Finance will go for increase of rates of their securities. "If we look at profitability of government securities, it has increased twofold. If earlier the private pension funds spoke about 3% profitability, nowadays it reaches 6%. And we would like to offer the government, that the profitability increases. The government will anyway have to compensate the profitability level that did not cover the accumulated inflation level. Therefore, we all are interested in increasing of the rate."

However, there was no agreement achieved: in 2013 the value of trading at the primary government securities market reduced by 8% – to KZT 982.5 billion, and at the secondary market it reduced by 16.8% to KZT 191.5 billion. Moreover, in 2014–2015 the use of transfers from the National Fund (i.e. oil savings) to cover the deficit allowed Ministry of Finance reducing of attracting more expensive money at the internal stock market and getting to external markets for its debt refinancing.

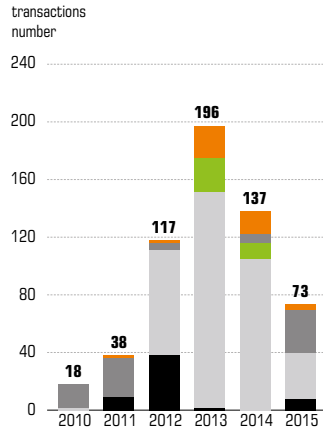
In October 2014, first time after a 14-year break Kazakhstan has successfully placed 10-year independent Eurobonds for USD 1.5 billion, and 30-year bonds – for USD 1 billion, at 3.875 and 4.875% per annum. As a result of which Ministry of Finance refused from placing MEKAM at the internal stock market: the value of government securities traded at KASE reduced by 12.4%, while the foreign debt of the government sector (government and National Bank) increased by USD 2.6 billion

FUNDING STRUCTURE AT THE PRIMARY BOND MARKET

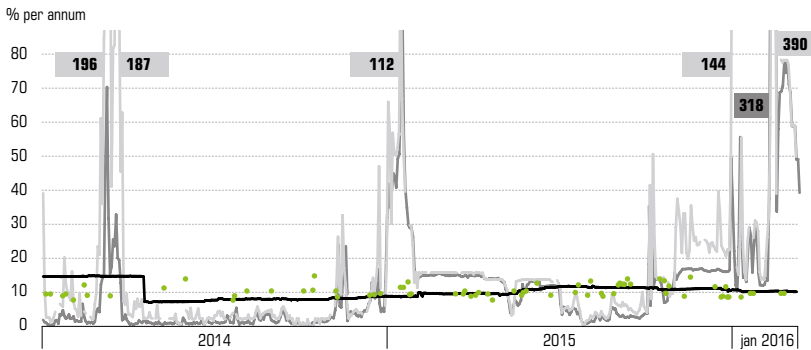
VOLUME OF INITIAL OFFERING OF CORPORATE BONDS BY SECTORS



ACTIVITY OF INVESTORS AT OFFERING OF CORPORATE BONDS



CORPORATE BOND MARKET AND MONEY MARKET YIELDS IN 2015–2015



during a year. In July 2015 the Ministry of Finance has again placed the 10-year independent Eurobonds for USD 2.5 billion with profitability of 285 basis points to American treasury bonds, and 30-year bonds for USD 1.5 billion with profitability of 335 basis points.

"Yesterday we have placed USD 4 billion. The request was almost for USD 10 billion. Thus, we can say that Kazakhstan has placed them rather successfully. This was the first placement of such a big volume after a long period of uncertainty amid a backdrop of Greek events, negotiations of the "Six-nation group" with Iran... In accordance with the program we continue placing, i.e. we show, arrange the yield curve. This is already a rather good assessment of investors' risks. Besides, shaping of the yield curve is very important both for those investing in Kazakhstan, and for our emitters – this is a quasi-public sector and private companies," – Bakhyt Sultanov, Head of the Ministry of Finance, reported¹⁶.

Consequently, the internal government securities market has finally stagnated – at 2015 year-end borrowings of the Ministry of Finance at KASE were only KZT 419.6 billion instead of the planned KZT 928.2 billion. At the secondary government securities market the extremely low liquidity was registered. The fall was (-95.9% – to KZT 8.2 billion), and the total trading value reduced 58.4% to KZT 427.7 billion.

In this situation, the UAPF and its administrator, represented by the National Bank, have found the required liquidity at the market of corporate bonds. In September 2014 NBRK has started the program of support of the banking sector, as part of which, beside participation in auctions on depositing pension funds, the largest banks have been issuing bonds for 7–8 years at eight and more percent per annum. The start was marked by Tsesnabank, which on September 26, has attracted KZT 10 billion for 6.5 years at 10% per annum. Considering that the inflation was low at that point of time (slightly more than 7%), buying these securities UAPF could provide a real positive profitability to its depositors.

The ball started rolling. Out of 34 specialized tradings on placement of corporate debt securities carried out at KASE in 2014 70% were with bank bonds, and their total value reached KZT 345 billion (+68.3%). This was the biggest figure in the history of KASE. However, the volume of secondary trading continued reducing, and at the end of 2014 it did not exceed KZT 103.6 billion (-44.7% to the preceding year), which was unavoidable at the "single investor market".

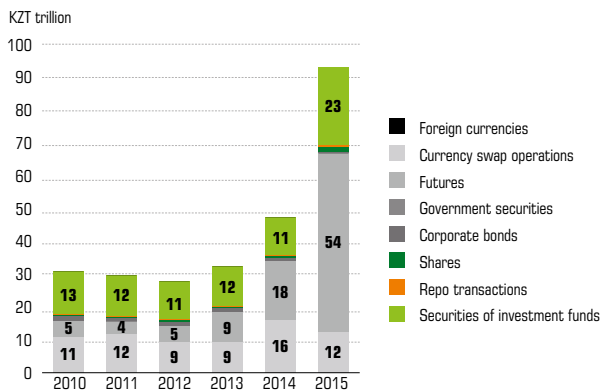
Having got UAPF as the buyer, banks became able not only to solve issues connected with their funding. They started reselling the liquidity to other players at repo and swap market at much higher rates, which were not regulated at that time, significantly differed from each other, and did not comply with rates of liquidity provision to banks through purchasing of their bonds.

This schedule, being not much market-based though, was fine with both sellers and buyer, and in 2015 another record was set at the stock market of corporate bonds – the trading volume increased by 174% to KZT 1,228.6 billion. In what connection both maximum volumes of primary placements (KZT 1.01 trillion, 88% of which were with banks' securities), and significant increase in activity at the secondary market (KZT 216.6 billion) were registered here. By the end of the year capitalization of corporate bond market increased by 36.9% and was KZT 9.1 trillion. Accelerator of this figure increasing, apart from issuing activity of second-tier banks, was national currency devaluation in 2015. Consequently the capitalization indicator significantly increased at the expense of dollar-denominated bonds. Profitability of bonds in KZT at the secondary market increased with weakening of tenge to dollar. This has provided a significant growth of KASE_BY Index in the second half of the year, and at the year-end it has reached 11.42% per annum.

In general the period of 2013–2015 was a turning one for KASE in terms of players' activity. After a years long recession total volumes of trading started increasing. Plus, the rate was constantly increasing: in 2013 – +16.3% to KZT 32 trillion; in 2014 – +45.9% to KZT 46.7 trillion; and in 2015 – +97% to KZT 92 trillion. The main contribution into these records was made by the financial market, i.e. repo and currency swap transactions, which activation mechanism was described above. But there were their own records at the securities market, although not market-based. Anyway, it was the achievement of KASE, as the trading platform has provided market participants, regulator and Ministry of Finance with the well-functioning stock exchange infrastructure that allowed everyone completing their tasks.

In short, despite of all challenges and transformation things were humming at the stock market.

DYNAMICS OF TRADING VOLUME ON KASE BY SECTORS IN 2010–2015



PEOPLE'S IPO: LIFE AFTER START

Debutant has Satisfied Expectations

In 2013–2015 stock market had been developing under the positive influence of “People’s IPO”. According to results of first incomplete two months of trading shares of the program debutant at KASE it has become clear that KazTransOil JSC was a right choice. By February 5, 2013 shares have been traded at a price 12% higher than the offering price. APF have given a substantial support to the market, investors did not hurry up to force income, they preferred to keep the securities in the portfolios. Subject to a positive market background they were ready to wait for further growth of shares price. Activity of secondary trading was rather high – from December 25, 2012 to February 5, 2013 the volume of transactions with KZTO ordinary shares exceeded KZT 3 billion, about 1,400 transactions were concluded. As a comparison, the volume of trading of ordinary shares of Kazakhtelecom JSC, second in terms of liquidity, in the same period did not exceed KZT 1.2 billion, and the number of transactions was slightly more than 300.

Everything, what financial experts and state were seeking for when launching the “People’s IPO” program, was achieved – to bring securities to the stock market that would give an impulse to its development, would allow Kazakh citizens becoming owners of the most successful and largest national companies and would contribute to growth of private investor class. The debut security of KTO has shown it was possible.

In the first months after IPO carrying out, daily about 30% of share securities trading were trades of KazTransOil shares at the secondary market. That said, at the beginning of 2013 an important trend was noticed that confirmed the growth of confidence of population to the stock market: with the reduction of trading values at the currency market the turnover of securities market increased. Everyone hoped that the speed and number of opened trading accounts would be kept. Especially that the program of initial public offering was planned to be continued. But, the reorganization of another large sector of financial market started – reorganization of pension system, which consequently introduced material changes into the behaviour and landscape of the Kazakh securities market.

For instance, when the work of pension funds at the market was prohibited, KazTransOil quotations have fallen down to KZT 760. Then the National Bank has allowed funds to work with shares of “People’s IPO” debutant, and KTO quotations have immediately increased to KZT 800 for a share. All this has confirmed the fact that for normal market development various types of investors have to work in it.

Once it has become clear that the floatation of the second “blue-chip company” – energy provider KEGOC – was postponed, players have focused on KazTransOil and by the start of 2014 the price of the share reached KZT 1,300 (with offering price of KZT 725).

Anyway, in the absence of new instruments by the end of 2013 the effect of IPO of KazTransOil JSC and of “non-people’s” IPO of Kcell JSC started fading: the

volume of transactions reduced by 42.5% to KZT 117.5 billion at the secondary market. The market wanted new "blue-chip companies".

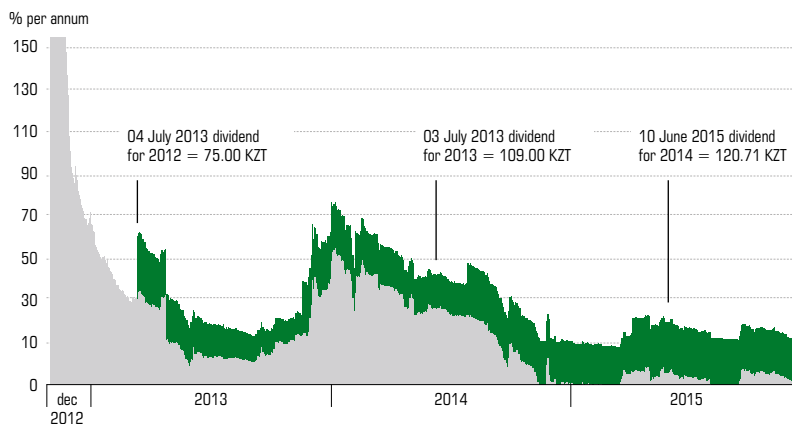
Wrong Time for a Right Company

The long-awaited placement of KEGOC shares at KASE through subscription took place in December 2014 only. And it was not a good time for that. By that time the market was recovering the February correction of KZT, fall in global oil prices and ruble weakening. Some internal problems of the largest issuers were noticed too. For example, the information on internal investigations regarding work of Kcell JSC with external suppliers initiated by the Board of Directors and sudden resignation of Financial Director affected quotations of Kcell JSC shares. Ordinary shares of KazMunaiGas Exploration Production JSC also lost some interest for investors due to uncertainty about special dividends, and speculations with shares repurchase by the parent company. In sum, there was no bullishness.

However, the interest to securities of the national electric grids operator was rather high, which affected the figures of accounting system of Central Securities Depository of Individual Persons. Their number has increased from 55.4 thousand in August to 99.5 thousand in December. Such interest was also confirmed with the following: during the first two days of share subscription Kazakh citizens have applied for purchase of 182 thousand securities of KEGOC JSC¹⁷.

In total, there were 42,723 applications received at the stock market, for the amount of KZT 16.7 billion, which was 1.3 times as much as the announced flotation value. The demand from brokerage companies and their clients – physical persons – was KZT 9.7 billion or 73.7% of the scope of offer, and from UAPF – KZT 7 billion, or 53.3% of the offer. In other words, there was an oversubscription like in KazTransOil

PROFITABILITY OF ORDINARY SHARES OF KAZTRANSOIL JSC IN 2012–2015

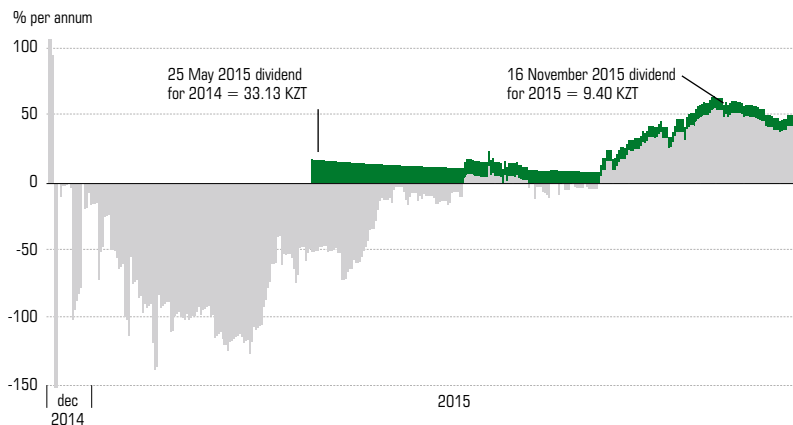


JSC situation. It was interesting that wider groups of investors including regional population took part in the subscription for KEGOC shares. To the great extent it was provided by the appearance of a new broker, Freedom Finance JSC, at the market. The company displayed an active attitude in engaging physical persons having lost less than three percent of physical persons subscription to KazPost (28.1% – KazPost, 25.6% – Freedom Finance JSC), and won the first place in the number of requests collected. This broker relied on IPO of KEGOC JSC having arranged the subscription all over Kazakhstan, and hoped to increase his customer base.

“While taking part in the “People’s IPO” program we were the only broker who had been advertising,” – remembered Timur Turlov, Founder and Head of Freedom Finance Holding. “Later on we have built a branch network, though we did not know what it was going to result in. It was important for us that people from Taraz, Semey, Aktau and other regions could buy shares. Since, if we did IPO in Almaty only, we should have understood that only one and half million of people would be covered, and that would be it, no one else would take part. As part of the program we have conducted several hundreds of free seminars, we had distributed brochures, invited people to attend seminars, developed the program and made presentations. And here we have found a large number of learned people, who knew about the stock market and were ready to tell others their success stories”¹⁸.

As a result, requests of physical persons were satisfied in full, and the offering price of a share was KZT 505. However, as opposed to KazTransOil JSC, KEGOC shares declined once at the secondary market. On the first day of trading there was no demand from institutional investors, and the only large participant, UAPF,

PROFITABILITY OF ORDINARY SHARES OF KEGOC JSC IN 2014–2015



decided to hold back from buying shares. Besides, entry of the company into the secondary market coincided with the "black Tuesday" in Russia, when the ruble rate has risen quickly in respect of dollar, and reached 80 rubles for US dollar. Taking into account the devaluation expectations on the border of 2014 and 2015, there were no many people willing to buy equity instruments in tenge at the market. Those who just bought KEGOC shares used to sell them at once in order to buy a foreign currency or related instruments.

On March 30, 2015 price of KEGOC shares plummeted up to KZT 300 per share. Just from this level the price recovery to its record high of KZT 1,560 started; and in November 2018 the shares are at this level. For example, increase in value of shares in the first half of April 2015 allowed investors, those who entered at the "bottom", earning up to 900% per annum.

The influence of the "People's IPO" program on the liquidity of Kazakh securities market can hardly be overestimated. In 2015 both companies passed through the program were at the top of KASE liquidity ranking. The program has increased the liquidity of securities so having reduced the investment risks. At the end of 2015 43% of the entire turnover of the secondary stock market involved securities of the "People's IPO".

And what's the main, with direct involvement of the stock market, implementation of this program allowed 10 times increasing the number of Kazakh citizens who owned shares of the best domestic companies. Many of them became active investors. For instance, in 2015 the number of players regularly working at KASE has doubled at least. Every month 250 to 750 accounts were involved in transactions.

As time has shown, the status of a holder of a "blue-chip company" stocks produces a reasonably good profit. With account of dividends paid, average profitability of KEGOC shares from the date of their placement was 37% per annum, and of KTO securities – 19%.

The First Public Start-up

Involvement of the general public into work at the securities market allowed implementing of one more interesting project at KASE. On April 9, 2015 at the trading floor a solemn ceremony of start of trading of ordinary shares of BAST JSC mining company at the secondary KASE market took place. Public share placement in classic IPO format was carried out before that. Subscription was conducted according to the schedule established as part of the "People's IPO" Program at KASE; and Freedom Finance JSC was acting as an underwriter.

In total, there were 579 requests submitted by physical persons through four stock market members from 516 personal accounts for purchase of BAST JSC ordinary shares for the total amount of KZT 427.1 million. Demand has overtaken supply by 6.1%. Herewith, 522 requests of physical persons were satisfied for the amount of KZT 359.6 million. With account of shares retained by the underwriter in his portfolio for fulfilling of market-maker's duties at the stock market, BAST JSC has sold out all shares to be placed at KASE.

Having organized this placement, Freedom Finance JSC created three precedents at the Kazakh stock market. The first precedent: use of stock market instruments for financing of a relatively small company when it is hard to get a loan from a bank. The second precedent: carrying out of classic IPO in Kazakhstan for a small business, actually a start-up company, having demonstrated that it is possible and the way to do it. The third precedent: strong underwriting (with all shares bought from the issuer before placement) by a KASE member during shares placement, for which reason the issuing company almost had no risks connected with the placement.

“Placement of shares of mining company BAST has proven that Kazakh stock market can really raise money inside the country,” – Timur Turlov emphasized. “The company has managed to get more than USD 2 million, and quotations increased by almost 40% after the IPO. After successful placement of BAST JSC securities at the market, we received a lot of offers from various entities. And all of them with a view to obtain funds. That’s quite understandable: when bank loans are very expensive, everyone is seeking for equity financing.”

In general, a growth was registered in 2015 at the stock market. The traded value increased more than 4 times and reached KZT 899.6 billion. Although this record was to a greater extent connected with including of NC KazMunaiGas JSC ordinary shares in the official list of KASE, and carrying out of a single transaction on transfer of ownership rights to 10% stock of shares from Samruk-Kazyna NWF to the National Bank, thanks to placements conducted shares trading at the market became very active, and their liquidity at KASE considerably increased. At the stock market at the year-end the most liquid instrument was KEGOC JSC ordinary shares, with which more than 17 thousand transactions were concluded. In various months of the year physical persons accounted for 52.5–65.2% of the stock turnover.

FOUR IMPORTANT STEPS TO BOOST LIQUIDITY

The stock market did not stop working on creation of conditions for increasing of the liquidity of instruments at its platforms. And in 2013–2015 the work was especially effective. KASE managed to implement four main projects in this field.

Trade from Any Place

From February 10, 2014 on the new rules of granting access to the formal securities market with the use of direct market access systems – DMA¹⁹, have been put in force. These rules had been developed with account of internet-trading practice effective at KASE for more than ten years. The purpose of the rules is to regulate the direct access to

the stock market and to bring the internet-trading practice into line with the best foreign practices. The internet-trading practice was not regulated earlier; the quality and reliability of software and hardware complexes of brokers, as well as knowledge and skills of users of such complexes were not checked. Direct access has great advantages. This way to work helped brokers reduce the operational load of divisions responsible for accepting, processing and fulfilling of customer orders, as well as to minimize risks of trader mistakes in fulfilling of those orders. For customers it is, first of all, convenience and a possibility to trade in any place and at any time if Internet and trading platform are available. It is no longer necessary to fill in a customer order and submit it to a broker, and then wait for a reply on execution/non-execution.

Particular attention of KASE to DMA project was caused by the increased trading activity and involvement of population in trading at the stock market. If in 2011 only two-three brokers provided such service, in 2014 more than ten professional market participants worked with direct access systems.

Access of foreign brokers and banks

The second project launched in 2011 was the Remote Membership project, aimed at involvement of foreign banks or brokers in work at KASE platform. The project enabled such companies to become KASE members without any intermediate parties and to directly trade instruments of their interest at the market. The first signs here was Russian Promsvyazbank PJSC admitted to KASE members in "currency" category from June 1, 2011. In 2014 the stock market has finished the development of the updated requirements and conditions for foreign professional participants to become KASE members; the procedure of receiving by foreign companies of the KASE member status was determined; and the requirements to acting remote members and procedure of their working at KASE were updated. By the end of 2018 three foreign entities have been working at the stock market as remote members.

Listing is not a Rating Anymore

One more step on the way to liquidity enhancement was reorganization of the formal list of securities and requirements to listing securities and their access initiators. The reorganization was performed by KASE in cooperation with the National Bank in 2014. In fact, principles of the listing had been changed; with new rules carried into effect it could no longer be considered as a quasi-rating and indicator of investment quality of instruments. In developing of the new structure of KASE formal list liquidity indices were the main guidelines. In particular, in the share sector two categories were distinguished – the category of liquid securities and the category of informational listing. Thus, the new listing structure provided tradeability guidance and ensured maximum disclosure of information on issuers and their securities. That said, investors had to assess the quality of securities by themselves in order to make decisions about investments.

“Discussions of what is to be the main criterion in making an investment-related decision have been conducted over extended periods,” – remembered Galina Tsalyuk, Managing Director, Director of Listing Department of KASE. “We were rather interested in this issue too, as the stock exchange was dissatisfied with the existing investors’ opinion that if a security is included in the stock exchange list, it can be bought; and if it is in the first or the highest category list, such security must be bought. That means, for some reason they have equated the word “listing” with “reliability”, and listing became something like rating. Herewith the stock exchange believed otherwise, as securities of any company have some risks, of different level though; the stock exchange has urged investors not to rely on the listing but carefully assess risks of their investments... In 2008 two existing regulators (Almaty Regional Financial Centre (ARFC) and Financial Inspection Agency (FIA)) decided to implement a common practice in Kazakhstan, that required the availability of a rating of a debt security. Consequently, for investors to feel more confident, debt securities were divided into two categories in the formal list of the stock exchange – with rating and without it... As it is well known, no one was protected by ratings in crisis. During the crisis rating agencies even were not always able to timely react on the situation... Therefore, starting from 1 January 2015 we have refused from ratings at all. Luckily the 189th resolution of the National Bank was issued, where no requirement of ratings was mentioned. The National Bank has changed its approach and decided that there is no need in rating for the listing, they remained as criteria for investing in securities of money of licensed financial institutions. In order to make it easier for UAPF to know the list of securities of the stock exchange in respect of facilities to invest pension savings, the debt securities were divided into two categories – bonds of quasi-public sector entities and of all other issuers. In terms of stock practices it was not much convenient. When in 2016 we have been writing the strategy of KASE development for three years, we have decided to take international experience as a basis for our formal list structure, i.e. to divide the classic types of securities between two platforms – the main and alternative platform, hereby having defined guidelines for investors”...

Trade Settlement on the Second Day

Finally, in 2015, after three years of hard work a successful implementation of partly secured T+2 settlement schedule. First time ever international norms were applied at KASE to transactions with KASE Index shares; the international norms provided settlement of a stock transaction two days after it was concluded. This step was important for developing of market infrastructure and increasing of its attractiveness for foreign investors.

"In the most stock exchanges of the world the T+2 system has been launched (to submit a request, buy a security and pay for it takes 48 hours only), and we have T+0," – Maksat Kabashev, KASE President at that time, explained the necessity in the project. "And before you can buy, you have to make a 100% pre-payment, place some money upon deposit here and trade using it. What serious investor is going to trade here under such terms? Sometimes investors can't complete a transaction on a same day basis simply because of the geography: when it is night in New York, in Kazakhstan is day, and vice versa. One day passed and we are going to fine the investor that he has not completed transactions, and he still has the very morning. That is why investors are not happy to come to our stock exchange. What a decent investor does: first he buys a security, then pledges some securities from his portfolio – he can do it at the very same stock exchange, or borrow funds from a bank in order to buy a security, can borrow some money from the buyer, in order to resell it together with the buyer to someone else at higher price. In short, a usual speculative process is going on. What the time lag is needed for? 48 hours are enough to complete the transaction"²⁰.

KASE rules regulating the T+2 settlement procedure have come into force on June 1, 2015. On the same day KASE and Central Security Depository have signed an Agreement regulating all issues between KASE as a clearing organization and Central Security Depository as a settlement agency. And on June 29, a test operation of stock exchange information systems started. As of November 25, the new T+2 settlement system started being applied in work with KazMunaiGas Exploration Production JSC shares, and as of December 23, all shares of KASE Index representational list were transferred to T+2 schedule. In order to provide all participants with an opportunity to raise funds necessary for settlements on the new schedule the stock exchange has also created a new financial instrument type – repo with net settlement.

New Currency Pair – Yuan for Tenge

After a long period on September 25, 2014 a new instrument appeared in the currency sector. On this day KASE has started trading with Chinese yuan for tenge. This was the result of work performed on the initiative of the National Bank and KASE with account of recommendations of Kazakhstan-China Subcommittee on Financial Cooperation. In point of fact, the necessity in implementation of a stock mechanism of tenge/yuan exchange existed in reality. It was both a reflection of economic reality and political action illustrating developing relationship of two countries. To the end of 2014 more than 30 transactions were concluded with this pair, amounting to KZT 131 million. Forecasts for this instrument were high with account of rates of growth of turnover between two countries, and, as time has shown, they were right.

NEXT and FIX

Improvement of trading and settlement KASE procedures were synchronized with technological development. As early as 2012 the stock exchange started developing a new trading system, which was supposed to be 100 times faster and be able to process 20 thousand requests per second. This had complied with the world's practice of stock trading. Making a decision took some time – specialists and management of KASE have processed fifteen proposals of world leading developers, including the most famous stock exchanges, and analysed everything carefully. After all the trading system is the main instrument of stock exchange activities and connection with market participants. Finally, a decision was adopted to create the own trading system, particularly as the stock exchange already had enough experience in this field.

The project got the name "NEXT". In 2015, as a result of a three-year work servers of the system have been commissioned, as well as the trading terminal for KASE currency market as the most liquid one. The market of securities, money and derivative instruments continued functioning at ACT, which was from time to time upgraded. NEXT terminal allowed making all basic trading operations of the stock exchange: request filing and cancelling, tracking of participant's positions; looking through trading, quotations and diagrams; submitted requests and completed transactions of a participant, as well as tracking of daily positions of a currency market participant, his liabilities to the stock exchange relating to sold currency and stock exchange requirements to the participant relating to bought currency. The terminal operated with FIX-protocol version 5.0 and higher and provided a possibility of connection both to transaction FIX-communication server and FIX Market Data.

In 2015 the development and commissioning of FIX Market Data (FIX MD) server, developed based on FIX-protocol version 5.2, became the project connected with NEXT. Using the FIX MD server users were able to get the list of securities traded at KASE, information on trading in online mode, and to get the course of trading reconstructed in case of a connection fault. Besides, thanks to FIX Market Data launch trading broadcasting from the trading system at NEXT platform became available on KASE website.

CHANGING LEGISLATION

Big amount of work of the stock exchange in 2013–2015, as in all preceding years, was connected with improvement of specific legislation. Being in the very heart of financial infrastructure, in fact performing liaison between issuer companies and investors, state and community of professionals, KASE have clearly seen all "bottle necks" limiting participation of the stock market in development of the economy.

In 2013 the stock exchange has consolidated all its proposals regarding the securities market development to the government and National Bank. The consolidated document covered 22 issues connected both with conceptual

approaches to interrelation between government programs of industrial and innovative development and national securities market, and with more particular proposals – from listing reorganization to technical aspects of activities and regulation of certain market sectors.

In particular, it was offered that all real sector companies that went after material assistance under their investment projects scope (e.g. through investments to capital, targeted financing, government orders, fee rates subsidization, provision of municipal and infrastructure services) accepted obligations on listing of their debt and equity securities at the national stock exchange and on IPO performing.

In its turn, the state could provide for focusing of existing tax benefits for stock market entities specifically on securities that were issued by really public companies. And to introduce corporate income tax benefits for share issuers, which already have carried out IPO. This approach, on one side, would provide a maximum information “transparency” and control of implementation of investment projects with participation of the state based on information disclosure systems at KASE. On another side, it would create a possibility of a correct “exit” of the state from those projects upon their completion through the appropriate SPO.

Creation of equal competitive conditions for bank crediting instruments and debt stock instruments was considered to be the important condition of pro-business state programs at the stock exchange. In connection therewith in 2015 KASE came forward with an initiative on implementation of mechanism of coupon rate subsidization on corporate bonds and their principal debt guaranteeing. Later on, after appropriate amending of legislation and elaborating of implementation mechanisms with Damu fund, state guarantees on bonded debts became both a measure on protection of rights of investors and a factor for reduction of business funding cost.

In the legislation development area KASE has always worked actively in cooperation with state development institutions, regulators, public associations and communities of professionals, international experts. Thus, as part of corporate management best practices implementation in Kazakhstan, the stock exchange has taken an active part in the project of European Bank of Reconstruction and Development SJ BERWIN LLP regarding: “Kazakhstan: review and reform of legislation in the corporate management area”. The project was aimed at rendering assistance and support to Kazakh companies for gradual change to international corporate practices. Besides, successful project implementation contributed to increased transparency and sustainability of national stock market.

In 2015 on the initiative of KASE the Working and Technical Committees have been created under Financial Institutions’ Association of Kazakhstan for discussing of a wide range of issues connected with securities market development. Most of proposals made at these platforms further created a basis for programmatic documents and normative legal acts of state agencies.

Concerted efforts of KASE, FIA and Atameken RK National Chamber of Entrepreneurs produced a significant synergetic effect.

“One of 16 specific Committees of Atameken RK National Chamber of Entrepreneurs – the Committee of Financial Sector, headed by Umut Shayakhmetova. Therefore, we can perform all inspections, market initiatives, discussions with the Government, National Bank, Parliament and expert community through the two permanent platforms, Committee of the National Chamber of Entrepreneurs and Financial Institutions’ Association of Kazakhstan,” – Yuliya Yakupbayeva, Deputy Chairman of the Management Board of Atameken RK National Chamber of Entrepreneurs²¹, explained the work of this system.

IN PURSUANCE OF INTERNATIONAL STANDARDS

In 2013 KASE has got the status of the full member of the World Federation of Exchanges (WFE), which confirmed compliance of main aspects of Kazakh trading platform activities with international standards and world’s best practices. After all, WFE membership of the exchange is usually considered by regulators, investor associations and large investment companies as a compulsory condition to enter markets serviced by such exchange.

First time ever KASE has joined WFE in 1997 as an associate member, and in 2008 it has got a status of an affiliated member (affiliated market). From that time on one of key objectives of the exchange was to improve its procedures, mechanisms and services in order to bring them into compliance with requirements to full WFE members.

The result of five years of ongoing development was duly appreciated by foreign experts, who had studied activities of KASE in 2013 during the WFE inspection for preparation of a statement of compliance. Representatives of Istanbul, Shanghai, Korea exchanges, as well as Hüseyin Erkan, WFE CEO, have visited the exchange on WFE delegation. And Kazakh stock exchange has passed this test honourably.

On October 29, 2013 at the session of 53rd General Assembly of WFE in Mexico a decision was adopted to approved full WFE membership of KASE. This was one of the most significant events in the history of the stock exchange over the last years, which symbolized KASE recognition as an integral part of global exchange infrastructure and a fully-fledged member of global financial community.

The next milestone in achievement of world’s best practices was September 24, 2015, when KASE has joined the Sustainable Stock Exchanges (SSE) Initiative of the United Nations’ Organization. SSE Initiative has been created in 2009 by Ban Ki-moon, Secretary-General of the United Nations, and represented a global platform where exchanges have been discussing possibilities of stable development and problematic issues now existing at the capital market. In fact, having joined SSE the stock exchange has voluntarily undertaken obligations to facilitate the improvement of information disclosure and achievement of compliance with international standards in the field of environment, social issues and corporate governance (ESG) among listing companies, professional market participants and investors.

The final chord of three-year work of KASE on reinforcement of its international image was signing of several memoranda with its international partners and colleagues in 2015. They included stock exchange Nasdaq Dubai (for the view of experience and information exchange); Megawatt-X (in the field of development of wind and solar energy financing); London stock exchange (facilitating of access for investors and issuers to capital markets of Kazakhstan and Great Britain, enhancing liquidity of shares of Kazakh companies both at KASE and at the main LSE market), as well as Shanghai stock exchange and a long-standing partner – Thomson Reuters.

In Pursuit of a Strategic Partner

As early as 2011 involvement of a strategic partner from among the highest developing exchanges and international financial institutions was one of the mid-term key issues for KASE. These efforts were intensified in 2013–2015. The possibility of cooperation was discussed more substantively with Istanbul stock exchange (BIST). As a result, Framework Strategic Cooperation Agreement was signed in Istanbul on September 15, 2014. The agreement outlined the framework of the long-term cooperation including through shares cross purchase and joint work in all areas of the exchange activities including development of markets, products, listing procedures and technologies.²² Through the end of the year specialists of the two exchanges had been studying the experience of cross-trading projects implemented by other exchanges. The possibility of launching ETF consisting of shares traded at the both platforms was considered as a first step on the way of mutual access of trading participants to stock platforms of KASE and BIST. However, there was no continuation of this project and the Kazakhstan Stock Exchange has found a new strategic partner represented by Moscow Stock Exchange (MOEX) only in 2018.

* * *

Having chosen a free market economy model, Kazakhstan became exposed to all external, both regional and global risks and challenges right from the beginning. During the period from 2013 to 2015, the National Bank's new monetary policy experienced particularly strong influence of external shocks. The determination of the regulator and the Government to follow the chosen policy on inflation targeting and on preserving a freely floating exchange rate regime also came under hard pressure. The inflation started rising; the salaries, deposits and other savings in tenge have depreciated in terms of US dollar equivalent. It were these two factors that determined the degree of social sentiments. Therefore, curbing an inflation and the dedollarization of the consciousness and habits could become a key to the success of the National Bank's monetary policy.

In the coming years, the Kazakh National Bank had to quickly to address these two tasks before moving on to further deepening of the financial market reform, encompassing all sectors: banking, pension, insurance and, of course, stock market. The stated liberalization of the stock market emphasized the significant importance of the stock market. It had to play an important role in the implementation of the money market strategy, real sector financing, in the development of domestic investor base and in increasing the profitability of pension assets.



talks





Chapter 7

FUTURE IS CREATED TODAY

ON INFLATION TARGETING TREND
IT'S TIME FOR THE SECURITIES MARKET
GROWTH STRATEGY

Chapter 7.

FUTURE IS CREATED TODAY

Late 2015 – early 2016, another turning point occurred in the development of Kazakhstan’s financial system. It was 2016 when the contemporary history of KASE as an integral part of the national financial market began.

ON INFLATION TARGETING TREND

Objectives and Conditions at the Start

In November 2015, the new Chairperson of the National Bank, Daniyar Akishev, was entrusted with challenging tasks. He had to stabilize the situation in the currency market, restore confidence in the regulator and the tenge, resume lending to economy by banks, and keep reducing the inflation rate developed with transition to the freely floating exchange rate regime. Serious issues required challenging and sometimes tough decisions with simultaneous resolving of less important system problems. The problems, which had been accumulated in the financial system, had to be solved under the conditions when the national economy faced shocks caused by the reduction of global oil prices and US sanctions against Russia, Kazakhstan’s major trading partner.

By the beginning of 2016, Kazakhstan was under the inflationary pressure. At the preceding year-end, the inflation rate was 13.6% with the target value of 6-8%. With economic slowdown (1.2% GDP growth was the record low from 2009) and poor business activity, stagnation in lending operations of the Kazakh banks was observed. At 2015 year-end, the volume of lending to the economy was KZT 12.6 trillion with an increase as much as 4.7% (as a comparison, it was 7.2% growth in 2013). The share of currency loans was 33.7%; the volume of national currency loans decreased by 1.9%, and of foreign currency loans increased by 20.7%.

Foreign economic background was marked by recovery of the monetary policy of the leading central banks, slowdown in the growth of the largest world’s economies and commodity markets slump. The flotations in the exchange rates of the Russian currency and tenge in 2015–2017 mainly reflected changes in the most important fundamental factor for Russia and Kazakhstan, i.e. oil prices.

The dependence of Kazakhstan's economy on the resource base, and especially on oil sector, which directly provides about 20% of GDP, about 50% of income of the national budget, and about 70% of exports, always strengthened considerably in the event of fall in commodity quotations. Maintaining quotas for oil production volumes by OPEC member countries, dollar strengthening, shale revolution in North America, significant increase in oil product reserves in the U.S., and removal of a ban for oil exports from the U.S.: all this contributed to 46.9% fall in Brent oil price in 2015; the average Brent oil price in 2015 was USD 52.4 per barrel.

New Focuses and Instruments

In the existing economic conditions, the National Bank decided to conduct monetary policy focused on interest rate policy under the free floating exchange rate regime for the tenge in order to achieve its main goal of maintaining the stability of prices in the Republic of Kazakhstan. Inflation targeting policy was a mid-term one. Inflation target values were established: 6–8% YOY in 2016 and 2017; 5–7% in 2018 with subsequent gradual reduction to 3–4% by 2020.

To achieve these objectives, first of all, it was necessary to sterilize extra tenge liquidity, which had not been utilized by the real sector. At the same time, it was required to adjust the interest rate channel downwards so that, on one hand, to reduce the attractiveness of the dollar assets, thus restraining speculative attacks on the tenge and preventing growing expectations of devaluation; and on the other hand, to increase the stability of funding base in the tenge and to expand volumes of consumer and corporate lending through the reduction of lending cost in order to get a well-balanced market exchange rate of the tenge to foreign currencies.

The base rate that could regulate liquidity of the banking system and have influence on the money market and the targeted market rate was the main instrument of the National Bank in achieving the inflation-related goals. It was critical for the Kazakh National Bank to keep the balance between financial stability risks (i.e. not to overestimate the rate) and risks of unsubstantiated expectations of devaluation (i.e. not to underestimate the rate), in particular, in the first year after the transition to inflation targeting.

In fact, the base rate was supposed to be a symbol and constant signal for the market of the nature of the new open monetary policy conducted by the National Bank. In February 2016, the Kazakh National Bank fixed the base rate at a rather high level of 17%. This helped to make the tenge instruments more attractive, and, as a result, to reduce expectations of devaluation and inflation. It laid the foundation for gradual reduction of the base rate in the future. And it was really successful: it almost halved over three years. Since October 16, 2018 the base rate has been 9.25%.

The structural liquidity surplus, which was KZT 116.7 billion at the beginning of April 2016, KZT 2 trillion at the beginning of 2017 and KZT 2.4 trillion at the

beginning of 2018, became the main feature of the money market in recent years. To withdraw excess liquidity, the National Bank returned to the practice of selling its notes at auctions and to participation in KASE repo market as a borrower, as the most effective instrument.

During the first months of notes issuance, the demand at placement auctions of market participants considerably exceeded (1.5–2 times) the supply, which proved that the market actors had excessive tenge liquidity. Closer to 2017, the demand for notes, especially for weekly ones, stabilized and exceeded the supply by 20% on average. The level of yield was linked to the changes in the base rate. Thus, the yield of weekly notes slowly reduced from 18.3% per annum in April 2016 to 11.9% in January 2017, and further to 9.25% per annum at the beginning of 2018. The yield of longer notes was at a lower level.

For provision of liquidity the regulator used Lombard list securities buy-sell back auctions, and repo and currency swap transactions at KASE platform.

Money Market: Long-Awaited Balance

In December 2015, the National Bank made steps to restore and retain the balance in the money and currency markets. The established rate range, with the liquidity provided at the upper limit and withdrawn at the lower limit, regardless of the instrument type – repo or swap, allowed removing a spread between repo and swap transaction rates that was typical in 2015. This brought the speculative attraction of money market to nothing and allowed the regulator to sterilize the money market from “excessive” tenge through notes placement.

The second important circumstance was that liquidity was only provided at rates linked to the base rate. There were practically no chances to get the tenge at lower rates. On one hand, it caused the refusal of banks from funding in the open market as it was too expensive for them, and on the other hand, it disciplined the players and made them adapt to new economic conditions.

After first turbulent months in 2016 due to such adaptation, the situation slowly stabilized. The money market learned to work with the base rate.

Consequently, the cost of the shortest money at repo and swaps reduced from 80% in December 2015 to 25% at the end of January 2016. In 2018, borrowing rates in the tenge against security in US dollars fluctuated within the range of 6.40–11.20% per annum; and against security of government securities – within the range of 8.00–10.00% per annum.

On the Way to Dedollarization

In 2016–2018 the exchange rate of the tenge was formed mainly under the influence of two fundamental and usually interconnected external factors – global oil prices and changes in the Russian ruble exchange rates. Short-term internal

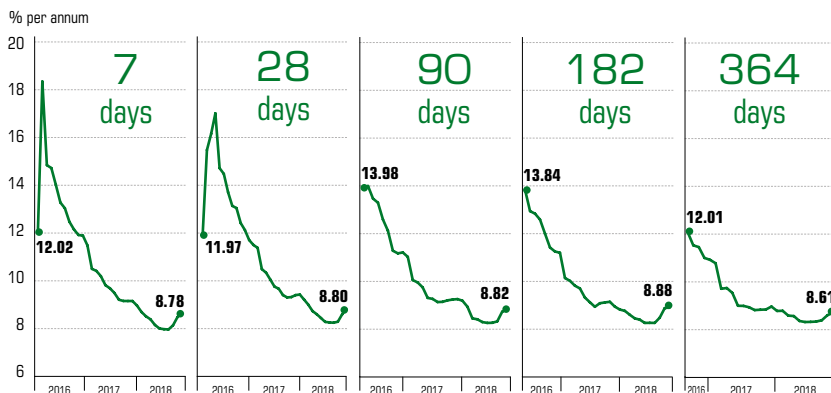
factors, such as periods of tax payment by large corporate players and occasional increase in devaluation expectations of population, had lower effect on the nature of the national currency movement. As it was promised, participation of the National Bank in currency trading was limited by smoothing of such short-term and speculative fluctuations.

Technical measures were implemented for the same purpose. On October 1, 2015 on KASE started publishing the weighted average market KZT to USD exchange rate, calculated based on two exchange sessions – morning and afternoon – on its website. The National Bank started using this index in establishing the official exchange rate on the next day. This allowed releasing the official exchange rate of a certain share of volatility caused by speculative movements.

For improvement of the exchange rate formation mechanism and generation of a more objective idea of supply and demand parameters at USD stock market in trading participants, at the National Bank's request, on December 15, 2015 KASE changed the system of quotations displaying in the trading system order book. The details of displaying participants' requests were limited to five best quotations for purchase and five best quotations for sales.

Since September 10, 2018 the official KZT to USD exchange rate has been established based on the weighted average market rate of USDKZT_TOM instrument, i.e. based on results of transactions with the settlement on the next working day (T+1 settlement system). The rules for establishing the official KZT to USD exchange rate did not change; as before, it was determined by the weighted average market rate following the results of morning and afternoon sessions. However, the exchange rate formation instrument changed. This transition was justified by the fact that T+1 settlement scheme provided a

YIELD OF NATIONAL BANK'S NOTES AT PLACEMENT

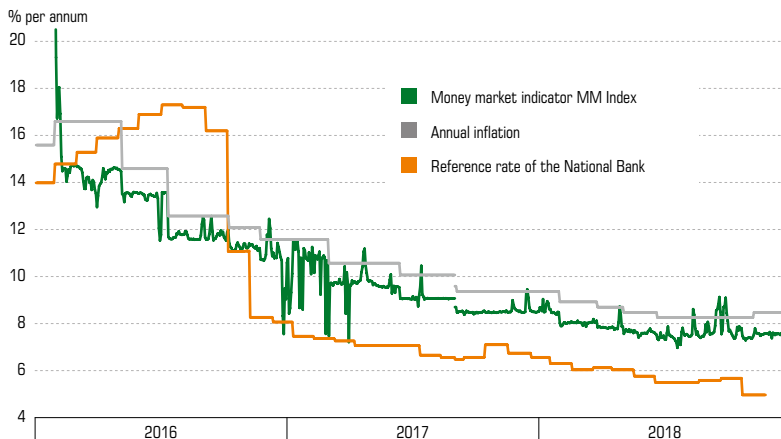


possibility to better manage the liquidity and contributed to volatility reduction in the money market. T+1 transition allowed banks and their major clients to take their liquidity planning more careful, and the regulator to respond to the current situation in a more efficient way and a chance to change such situation.

According to the Kazakh National Bank, the financial dollarization rate expressed as a share of loans to the economy was 61.3% at the end of 2015, and the dollarization rate of individual deposits was 79.0%. Further staying of dollar stock at the previous level would significantly decrease the effectiveness of monetary policy measures and increase the influence of the US dollar on Kazakhstan's economy. Besides, without dedollarization of banks' liabilities, full recovery of lending would be impossible in the future. Therefore, the National Bank focused on removing people's expectations and changing their behavior that supposed assets dollarization. The financial regulator explained its policy and position in respect of the essential issues to the ordinary Kazakh citizens and market players at press conferences, in press releases and at dialogue platforms.

Deposit rates were one of the crucial instruments to reduce the dollarization level. For corporate sector, foreign currency deposit rates were gradually reduced from 2.1% per annum at the end of 2015 to 1.3% per annum in October 2018. For individuals, the deposit rates were reduced from 2.9% to 1.6% per annum and in some banks to 0.5% per annum over the same period. As a result, in October 2018 the financial dollarization expressed in a share of loans to the economy and foreign currency deposits of the population was 23.0% and 49.0%, respectively.

INFLATION AND MONEY MARKET RATES IN 2016–2018



Assistance of the Oil Market

At the beginning of 2016, a trend reversal in the oil market prices toward sustainable growth created opportunities for strengthening of the KZT to USD exchange rate. The agreement between OPEC members and other oil producing countries on reduction of oil production volumes from the beginning of 2017 (OPEC+ deal) and disappointment of investors, who expected a shale oil production increase, had main positive effect on oil quotations. In Q1 2017, global Brent oil prices were higher than USD 50 per barrel, and by the beginning of 2018 they crossed the milestone of USD 65 per barrel. Consequently, the volume of foreign currency revenue generated inside the country was on rise, which considerably facilitated the solution of some issues for the National Bank, in particular, the dedollarization issue.

A positive external background improved the effectiveness of measures taken by the regulator, which manifested early in 2016. The attraction of currency speculations in the market decreased noticeably and the volume of the US dollars traded at KASE reduced by 46%. The market players and the population started reducing positions in foreign currency and preferred the tenge and instruments in the national currency to a greater extent. In 2016, the exchange rate of the tenge fluctuated within the range of KZT 325.40–380.80 per US dollar; in 2017 – KZT 310.40–345.00 per US dollar, with a fix at 2.1% and 0.3%, respectively. The strengthening within these periods was even higher.

Complications Caused by FRS and Anti-Russian Sanctions

However, not everything went smoothly. System strengthening of the tenge to dollar and relatively high rates of instruments in the national currency attracted foreign portfolio investors. The National Bank notes were the most attractive securities for them as a risk-free and relatively high-yield instrument. From March to the end of 2017, investors of this category kept the notes for KZT 150–200 billion in their portfolios, and from January to March 2018, the amount increased to KZT 450 billion. However, a new series of anti-Russian sanctions introduced at the end of April (with subsequent response from the RUB exchange rate) and increased FRS rate caused extreme outflows of capital of foreign investors from Kazakhstan. They would sell notes and convert the received tenge into dollars, so having reversed the trend of the KZT to USD exchange rate in favor of the US dollar in May 2018. According to Central Securities Depository, foreign investors had withdrawn about a billion dollars from Kazakhstan by September 2018.

Despite high volatility of foreign currencies market, the National Bank did not betray the declared principles. As before, the tenge exchange rate was generated under the influence of objective factors, and it remained a fully market and floating exchange rate, though hardly anybody in Kazakhstan perceived positively the national currency weakening from KZT 320 almost to KZT 380 for one US dollar in summer and fall 2018. The regulator had to respond by a small increase of the base

rate and notes yield. However, this did not result in any material consequences for inflation rate or dedollarization process.

To sum it up, we can make a conclusion that implementation of monetary policy of the National Bank resulted in lowered rush in the domestic currency market, reduced devaluation expectations of population, and allowed almost threefold reduction of the inflation rate from 13.6% in December 2015 to 5.3% in October 2018 YOY.

Restarting the Main Benchmark

In 2016, the National Bank together with the Ministry of Finance intensified their efforts to ensure conditions for generating a risk-free yield curve as a benchmark of money cost in the domestic market. This was especially important since after cancellation of the fixed tenge exchange rate on August 20, 2015 in Kazakhstan there were no tenge funding cost benchmarks for any long period. The curve built by the Exchange for several preceding years became outdated.

According to *Alina Aldambergen*¹, who headed KASE in February 2016, "With dedollarization and increased investors' interest in the tenge instruments, a new benchmark is expected to be developed. At the beginning of 2017 we expect the Ministry of Finance to enter the domestic market with new issues of MEKAM that would also contribute to determination of fair value of funding in the tenge, especially for medium and long periods. This is prompting suggestions that the next year is going to be more attractive for stock market of corporate bonds, and real sector companies would come to the market with interesting projects and rates acceptable for both issuers and investors."

DEPENDENCE BETWEEN THE USD/KZT EXCHANGE RATE AND VOLUME OF GOVERNMENT SECURITIES OF KAZAKHSTAN WITH NON-RESIDENT HOLDERS



THE AIFC PROJECT

The initiative of the Head of the State, N. Nazarbayev to establish the Astana International Financial Center (AIFC) as a financial hub for the CIS countries and for the entire region of Western and Central Asia was announced in May 2015, when the Plan of the Nation: 100 Steps to Implementation of 5 Institutional Reforms of the President was published; it provided for the following (Steps 70–73):

- Establishing AIFC based on AstanaExpo 2017 infrastructure with a special status assigned. Recording a special status of the financial center in the Constitution.
- Establishing an independent court system with its own jurisdiction, which will operate based on the English law. Judiciary will consist of foreign experts. In prospect, the financial hub of Kazakhstan to be included in the top 20 advanced financial centers of the world.
- Developing the AIFC Development Strategy focused on the maintenance of capital markets and Islamic financing. Developing new types of elite financial services, including private banking and asset management. Introducing a liberal tax treatment in the center. Implementing an investment residence principle based on the example of Dubai.
- Introducing English as the official language in AIFC. Independent laws of the center to be prepared and used in English.

- Providing international transport accessibility of the financial center. Creating a network of regular and comfortable flight connection between the AIFC and leading financial centers.

On May 19, 2015, the Decree of the President of the Republic of Kazakhstan *On Astana International Financial Center* was signed.

The Constitutional Law of the Republic of Kazakhstan *On Astana International Financial Center*², which assigned the status and parameters of AIFC operation, was adopted on December 7, 2015. Astana International Financial Center Administration JSC was established to manage the center.

Capital market development, asset management, private banking, Islamic finance and new financial technologies were defined as principal directions of AIFC operation.

It was planned to launch a stock exchange as part of AIFC equipped with the cutting edge trade and settlement technologies and operating under English law. It should be noted that the original AIFC project assigned the role of the exchange to KASE, which was supposed to be duly upgraded. However, later the AIFC management decided to establish a new exchange in AIFC that was named AIX (Astana International Exchange); an official ceremony of AIX opening took place on July 1, 2018 with participation of the President.

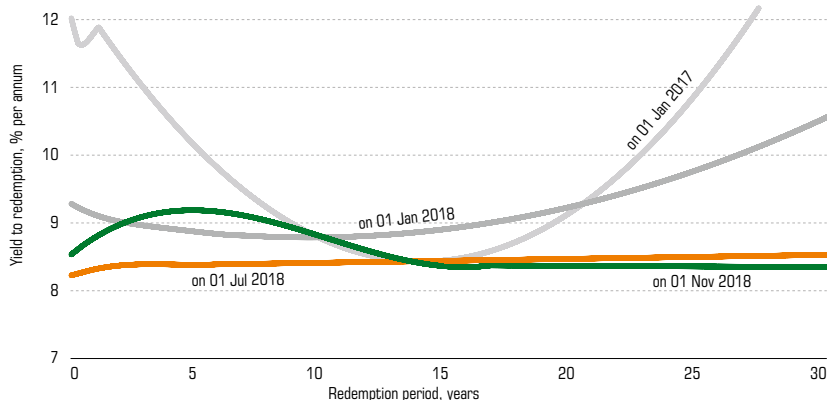
The risk-free curve for up to a year was developed for an account of the National Bank's short-term notes. In order to build the curve for periods longer than those provided by the notes, the National Bank sold 12, 15 and 17-year government securities of the Ministry of Finance from its portfolio in KASE trading system. In 2017, the Ministry of Finance issued new notes with the maturity periods from 2 to 15 years. As a result of joined efforts of the Kazakh National Bank, the Ministry of Finance and KASE, the market for the first time in a long period got a benchmark to determine cost of the borrowed capital inside the country. Under the pressure of declining inflation rate and reducing base rate the risk-free yield curve in Kazakhstan got its classical shape, when the securities with shorter maturity periods had lower yields than the longer ones.

Through this process, the financial system of Kazakhstan transitioned from high fixed borrowing rates in the corporate sector to the floating ones with benchmarks for base rate and risk-free yield curve of government securities. Building of GS yield curve as a new benchmark for corporate bonds placement generated a reducing price channel. Private business borrowing cost reduced gradually from 19% to 11% per annum. For quasi-public and financial sector, the cost of borrowings dropped even more – from 18% to 9% per annum, due to a higher level of issuers' reliability.

However, there was no gradual raise of availability of long-term loans to corporate sector for an account of borrowing rate reduction in the lending system of Kazakhstan. Starting from 2016, the loan interest rate for periods more than 5 years in national currency remained on the average at 15% and more per annum. In October 2018, the share of long-term loans was about 85% in the total economy loan portfolio.

Two of the latest interconnected projects implemented by the National Bank – government securities listed on the Clearstream system and GS market transitioned to T+2 settlement system – are supposed to result in further reduction of rates in the market.

RISK-FREE YIELD CURVE OF KAZAKHSTAN GOVERNMENT BONDS



On July 30, 2018, Clearstream² launched a new international line for the Kazakh market. According to the National Bank, implementation of the project allowed to improve the integration with financial markets and increase the inflow of additional portfolio investment to the local market, since foreign investor got a simplified access to the market.

In order to take full advantage of the line opened by Clearstream, the Kazakh National Bank, Ministry of Finance of Kazakhstan and KASE started working on the second project aimed at changing the GS settlement system in primary and secondary markets from T+0 to T+2. As the first step, starting from October 15, 2015 the auctions for placement of the National Bank's short-term notes conducted with T+2 settlement scheme. All GS settlements were also transferred to this scheme at KASE on December 4, 2018. All this provided the best conditions for foreign investors to participate in the GS market of Kazakhstan and laid the foundation for their appearance in the domestic market of bonds of quasi-public companies at least.

IT'S TIME FOR THE SECURITIES MARKET

Implementation of the new monetary policy of the National Bank resulted in favorable background for investment to the Kazakh securities created in 2016–2017 and the first six months of 2018. The US and European stock market environment deteriorated, while there were relatively high interest rates registered in Kazakhstan with gradual strengthening and stability of the tenge. Securities, in particular Eurobonds and shares with an option of dividend income, got a role of beneficial alternative to the deposits in US dollars, whose rates of return reduced significantly for three years. With destabilization of some large Kazakh banks the tax preferences and interesting investment instruments available outweighed in the selection of retail investors toward the open stock market. Consequently, trading activity in the secondary equity securities market increased considerably, mainly for KASE Index shares. If in 2015 the trading volume in the secondary stock market (without the National Bank's purchase of 10% stock in KazMunayGas NC JSC) was KZT 149.6 billion, it increased to KZT 249.4 billion the following year, and to KZT 261.8 billion in 2017.

With the increased demand for KASE Index shares from investors, in 2016–2017 the index of blue chips of the Kazakh stock market could demonstrate explosive dynamics that had not been noticed since the financial crisis of 2008. Growing annually by more than 55%, KASE Index increased from 858.79 to 2,162.69 basis points and, according to Bloomberg, it was included in the top three share indexes of the developed and developing exchanges of the world by growth rate.

Retail investors' activity helped them to get the prevailing share in the structure of investors. Over the past three years, it was 55% on the average in the secondary stock market, and the number of individual accounts in the accounting system of the Central Securities Depository reached 113,679 based on the results of October 2018.

In July 2016, a subscription for ordinary shares of Aktobe Metalware Plant JSC took place at KASE to continue the small IPO trend laid in the preceding year.

In the course of placement, the company raised KZT 800 million. The total demand in the subscription reached KZT 2,975.3 million that was 3.7 times more than the supply. The demand from brokers was 8.9% of supply; 12.7% from legal entities; and 350.35% of supply from individuals, which proved the high potential of private investor base.

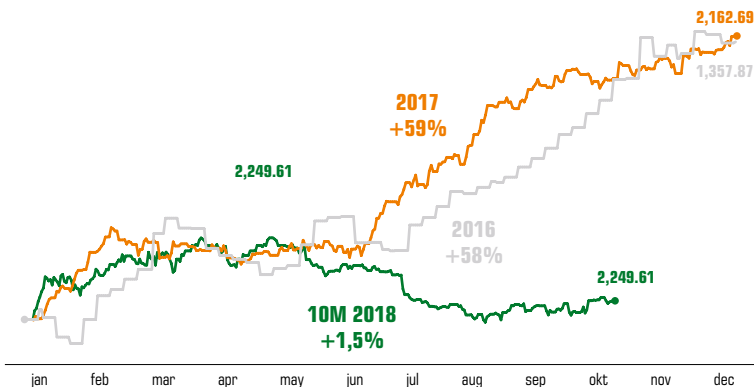
It should be mentioned that this placement demonstrated an opportunity of replacement of borrowed capital with equity capital raised. In the face of high debt ratio of medium-sized enterprises, this experience happened to be highly demanded.

Two more share placements, which took place at KASE trading platform in 2017, were the further proof of increased interest of investors in the tenge-denominated instruments. In March, BAST JSC in the course of secondary placement offer (SPO), raised KZT 1.1 billion. The demand from individuals was estimated as KZT 1,121.1 million, or 96.6% of the total demand. IPO of Bank of Astana JSC held at the end of June accumulated investors' funds for an amount of KZT 6.5 billion. The demand at subscription reached KZT 7,549.7 million and 1.5 times exceeded the primarily announced supply, with 93.5% of raised funds provided by individual investors.

Altogether, the KZT stability combined with reduced inflation rate and intensified marketing activities of KASE against the recovery of Kazakhstan's economy resulted in increased number of companies, whose securities were officially listed at the Exchange. In 2017, 37 bond issues of 25 issuers were listed at KASE and 11 issues of 11 issuers – in the stock market that demonstrated the best dynamics throughout the Exchange history. By the end of the year, the capitalization of KASE stock market reached a historical maximum of KZT 17 trillion, as well as a number of share issuers included in KASE trading lists (111), and a number of share titles (129).

There were positive developments in the corporate debt market, too. Continuously reduced inflation rate and therefore base rate from 17% per annum in January 2016 to 9.25% per annum in October 2018 had positive impact on the

KASE INDEX IN 2016–2018



borrowing cost for business, which was very high in 2015–2016. In addition, the National Bank and the Ministry of Finance completed building the new risk-free yield curve that became a benchmark for the Kazakh companies in determining the borrowed funds interest rate.

All this resulted in revitalization of the organized market of corporate bonds. The volume of exchange transactions increased both in the secondary and primary markets. Over the last two years, the share offer price fixed between 9.5 and 15% per annum. Besides, under the influence of the described factors, the structure of the investors of the primary market of corporate bonds had positive changes. UAPF participation in placements of 2017 did not exceed 8.1% against 89.5% in 2016. The legal entities, which were not institutional investors, were the most active investors. Their share was 43.7% against 16.9% in 2016. The positive fact of participation of a wide range of institutional investors remained in 2018, too.

GROWTH STRATEGY

The market records could not be a reason for KASE to rest on its laurels. After all, the only one wins in today's world, who can change fast. The new brand born in 2016 confirmed KASE's strategic striving for progressive changes, symbol of its contemporary history and confidence in success.

The previous brand had been successful for preceding 20 years. The infrastructure of the stock market of Kazakhstan had been laid with it. Therefore, based on the vast list of achievements of the Exchange, it was decided to keep the key graphic element of the brand – a triangle, transforming it into a prism thereby giving it a new meaning. Each surface plane of the triangular prism symbolizes KASE's forward-looking optimism, openness and availability, stability and reliability, professionalism and commitment to success. Green colour of the prism is the colour of harmony, growth, new prospects, safety and prosperity. Thus, the new brand of the Exchange represents the new stage of KASE development, where the striving for dynamic growth is based on rich experience and traditions.

KASE rebranding was followed with the updating of its "image" on the Internet – the official corporate website. As one of the main information resources on the Kazakh stock market, it incorporated a huge amount of information concerning Exchange members, listed companies and financial instruments traded at KASE. The new website www.kase.kz was characterized by its performance, user-friendly simplified interface and great informational content provided by a significant daily traffic of information messages created online in three languages: Kazakh, Russian and English. KASE commissioned its new website on January 3, 2018.

The KASE Development Strategy for 2016–2018 was the main symbol of KASE renovation. It included three directions, they were Stock Market Development, Improved Focus on the Exchange Customers and Services, and Improved Performance and Competitive Ability of the Exchange Business. The strategy kept the continuity of tasks, which KASE had been working on for many years,

such as increasing a number of securities issuers, extending investor base and introducing new technologies. However, some new features appeared in solving of these issues.

Different Platforms for Different Issuers

Throughout its existence KASE has been striving for creation of conditions necessary to finance the companies in the open stock market. There are many small and mid-cap companies in Kazakhstan, which make an important contribution to the national GDP. Therefore, developing mid-cap companies, including startups, became a new target segment of KASE. It was decided to provide an access for such companies to the stock market by transforming the listing, development and implementation of new instruments, and flexible pricing policies.

In 2017, the Exchange completed a project on transformation of the official securities list and reformation of requirements to listed securities and listing originators. There were three platforms operating simultaneously in the new structure of the official list, they were: basic trading platform (for securities of large companies), alternative trading platform (for medium and small issuers) and mixed trading platform (for securities of the other quality and form, including government securities, units of open-end funds, derivative securities, and IFO securities). The new structure was based on the international practice of dividing the stock market into two components – Main Market and Alternative Market. Such transformation resulted in a more transparent, clear and convenient official list structure for all categories of investors, issuers and other stakeholders. The Exchange facilitated the access to the stock market for relatively small companies, got an opportunity to perform the more efficient strategy to attract new issuers and investors. With the new approach of the National Bank, which extended the Exchange's authorities related to establishment of new trading platforms and sectors in the official list structure and introduction of listing requirements, KASE got great flexibility in control and improvement of listing requirements.

For example, at the Alternative Trading Platform the listing requirements and listing fees were considerably reduced, and disclosure requirements were only imposed to comply with the laws of Kazakhstan. From the date of alternative trading platform launch in June 2017, a number of securities issuers increased from 51 to 59, and a number of securities issues grew from 61 to 71, as of October 2018.

Altogether, with the assistance of the National Bank, in 2017, the stock market entrance procedures for issuers were simplified; the requirements for the registration of securities issues and disclosure requirements were enhanced.

In June 2018, KASE opened the KASE Startup Platform, which mainly focused on arranging communications between startups and investors. Such unconventional for exchanges trading platform was establish, first of all, to help new and promising businesses to raise funds for operation. The second objective was KASE's desire to provide opportunities for the companies to disclose information and search for investors in the open market. The official website was created for this trading

platform at: <https://startup.kase.kz/>. Six companies got access to KASE Startup for six months of its existence: PACK MAN LLP, Allavin LLP, Subscribe Online LLP, Smart Production LLP, Elephant Management LLP and REEF Centrifugal Technologies. Through implementation of the project, the young companies became more public and direct investment funds and private investors got comprehensive access to information on startups. Supported by techniques of work with issuers and investors improved over a 25-year period, the Exchange developed optimal requirements to startups interested in attracting investment to capital.

KASE Private Market intended for SME in a form of LLPs was another alternative source of financing for the companies without the need to get the public status. The launch of the platform in June 2018 opened new possibilities for all investors to purchase interest in promising projects and diversify their investment portfolios. Direct investment funds got the opportunity to raise investment both at the stage of raising funds and at the stage of exiting projects, and Kazakh small and medium-sized enterprises got an access to shared financing. This alternative to debt financing encouraged investment to the SME sector.

One of the main KASE objectives is to provide the Kazakh companies with an access to the public capital market. Such work is carried out both with potential and existing issuers.

In 2016–2018, KASE considerably extended its presence in the regions of Kazakhstan boosting the cooperation with potential issuers and investors. The database of the Kazakh companies, which potentially met the existing listing requirements or could be among such companies with some modification, was created at the Exchange. Since 2016 communication arrangements with potential issuers included in the database have been conducted consistently with assistance of Atameken National Chamber of Entrepreneurs, DAMU Entrepreneurship Development Fund, regional and municipal akimats. In April 2016, a Memorandum on Cooperation was signed between the Exchange and Atameken National Chamber of Entrepreneurs in order to improve joined performance to promote the domestic stock market as the financing source alternative to bank loans. The initiative of the Exchange was also supported by the Kazakh brokers, law firms and audit companies, whose representatives together with the Exchange employees spoke at “round tables” and meetings with entrepreneurs in the regions. They explained advantages of the stock market and steps to be taken to raise funds. In total, they have conducted more than twenty such events since 2016.

In June 2018, the Exchange started working with industry and professional associations. The advantage of such cooperation is that such associations unite companies of various sizes – small, medium and large businesses of the country. There are three directions of cooperation with such companies. They interact directly with the companies to attract association members to the Exchange. It is more efficient to distribute the information on the Exchange and its services via associations, as they already have data on the companies and present the companies of interest to KASE. The third direction is participation in associations’ events to present capabilities of the Exchange to their members, and invite associations and their members to KASE events and their involvement in training programs.

The Issuer's Days became the important channel of interaction with existing issuers. The purpose of the project is to introduce the practice of interaction between the listing companies and their investors, to build a conversation between the company management and shareholders, to improve the transparency of listed companies. In 2016–2018, the Issuer's Day was conducted by KEGOC JSC, KazAgroFinance JSC, Kcell JSC, KazTransGas JSC, Bank of Development of Kazakhstan JSC.

*At the same time the Exchange worked on improving the transparency of issuers' activities through changes in the reporting requirements. According to **Natalya Khoroshevskaya**, Deputy Chairperson of KASE, "We have made a rather good progress in the matter of information disclosure criteria. For example, in 2015 a requirement for an annual report to be made by listed companies was introduced. The guidelines for an annual report preparation were established. Our purpose was to get the companies focused not only on disclosure of financial reports and corporate events, but also on provision of investors with the detailed information on the background of existing performances, whether the company follows its strategy, and how transparent the company's decision-making structure is."⁴*

As part of accession to the UN Sustainable Stock Exchanges Initiative, KASE developed the report guidelines based on environmental, social responsibility and corporate governance criteria for the listed companies regardless of their size, industry or location. Consolidated reporting disclosure as well as financial statements disclosure has become a standard for public companies in the developed capital markets and is of increasing interest for investors and shareholders. This allows them to generate an adequate assessment of the company's performance for a long period. Commitment to ESG principles has recently become a global trend.

In addition, KASE started conducting regular training events free of charge aimed at improving the level of corporate governance in the listed companies. Such training sessions provide information not only on the fundamentals of corporate governance, but also on certain aspects of consolidated reporting, such as information disclosure, preparation of annual reports, interaction with investors, etc.

Involvement through Training

The exchange market is a place, where issuers and investors meet. The entire history of the Kazakhstan Stock Exchange confirms that a wide pool of potential investors is the best incentive for the new issuers to enter the exchange platform.

The KASE Strategy defined two vectors in improving the activity of a private investor in the Kazakh stock market: capturing interest of young generation and popularizing this type of investment among general public.

As part of the first vector, the Exchange arranged to conduct awareness-raising work at higher educational institutions of Kazakhstan. The purpose

of such cooperation is to raise awareness of the faculty and students of securities market, develop practical investing skills of students, share analytical information on the primary market trends. In addition, in order to generate practical experience and improve financial literacy of students KASE continued the Exchange Simulator project.

As part of implementation of the second vector, starting from 2016 the Exchange resumed the Contest of Retail Investors. The project is aimed at drawing attention of general public to the stock market, telling about alternative ways of investing money into financial instruments, making more people interested in the opportunities provided by exchange business. The contest participants demonstrate their skills of investing money in the real market by making sale and purchase transactions with shares of the KASE Index representative list. The 2017 Contest demonstrated the record number over many years of existence of such contest. There were 1,808 participants. They made 12,224 transactions for an amount of more than KZT 1,550,265,000, which was 42% of the total number of transactions with KASE Index representative list shares made for that period in the exchange trading system.

Training seminars for retail investors is another important component of this direction. At the beginning of 2018, KASE launched the training program How to Trade in the Securities Market. Its purpose is to raise the awareness of population of Kazakhstan of the domestic stock market and its possibilities. The training seminars are conducted on a quarterly basis, and they are free for everyone. The Exchange employees and brokers speak at such seminars. The program is intended to provide the audience with a full insight into the stock market and its basic elements.

“Frontier” Breakthrough

KASE is recognized by the global exchange community, and KASE’s performances are taken into account in positioning Kazakhstan in global market ratings of FTSE, S&P and MSCI. In 2017, FTSE increased the status of the Republic of Kazakhstan to the Frontier Market in its financial market classification. According to the annual review published by FTSE Russell Advisory Committee (Financial Times Stock Exchange group) in September 2017⁶ Kazakhstan was officially included in the list of frontier markets. This upgrade was a result of KASE efforts over the past years in implementation of T+2 settlements in the stock market. The position of Kazakhstan in the country classifiers of capital markets is the important indicator that reflects the level of stock market development for international investors to make investment decisions.

There is a new goal ahead – upgrading the status from Frontier Markets to Emerging Markets. Further improvement of Kazakhstan’s positions in international classifiers of rating agencies will allow extending the client pool through systematic development of the reliable exchange infrastructure, and, therefore, increasing the traded instruments liquidity.

New Instruments...

As a response to the market environment, which was characterized by increased volatility of rates and exchange rates in 2016–2018, in 2016, KASE developed and launched a new product – Commercial Bonds. This instrument differed from standard bonds in simplified and accelerated registration and listing procedure, short maturity period, and reduced listing fees. Such debt securities allowed the listed companies to raise funds quickly to replenish working capital, and investors – to limit the risks through a short maturity period. Since the implementation date, eleven issuers have already used this instrument. Twelve issues passed the listing procedure, volume of borrowing was KZT 22.6 billion, and the yield at placement varied between 11.00% and 14.88% per annum. The commercial bonds are traded in the secondary market, too. The total volume of transactions for the period from the launch date to October 2018 was KZT 11.1 billion.

Intensification of the stock market and trading in KASE Index shares resulted in a new event in the history of the Exchange. The first exchange traded fund registered under the laws of Ireland was let into KASE Index. On October 16, 2018, the shares of the Exchange Traded Fund (ETF) were listed and officially opened for trading at KASE Index at the Moscow Exchange platform headed by FinEx Investment Management LLP. Freedom Finance JSC provided the audit for the Kazakhstan market and the required broker infrastructure. FinEx Investment Management LLP acted as the index fund provider, ensured its operation and built interaction between all required ecosystem parties, and KASE, as the index provider, provides FinEx Investment Management LLP with required data on a daily basis.

*When opening the trades, **Timur Turlov**, Director General of Freedom Finance IC, commented on this product launch: "This is the first ever ETF for the Kazakh market assets. I am sure that the instrument will be in demand with a wide range of investors. For three years KASE Index has increased by 2.5 times, and demonstrated the best result among emerging markets. According to our estimates the potential of further growth of KASE Index from current level increases 28%. Institutional investors already trading at the Kazakhstan Stock Exchange will get an opportunity to easily create their index portfolio. In the future, the conditions are going to be created for comfortable hedging of risks of local Kazakh securities. Liquidity of the instrument is ensured by the market maker. With the appearance of ETF for KASE Index, the publicity and availability of the stock market of Kazakhstan will improve and, as far as I'm concerned, the Moscow Exchange platform is more than adequate for popularization of its instruments."⁵*

ETF for KASE Index is traded in the rubles and linked to the value of shares denominated in the tenge. KASE plans to list this ETF at its platform and open trading in its shares in the tenge by the end of 2018.

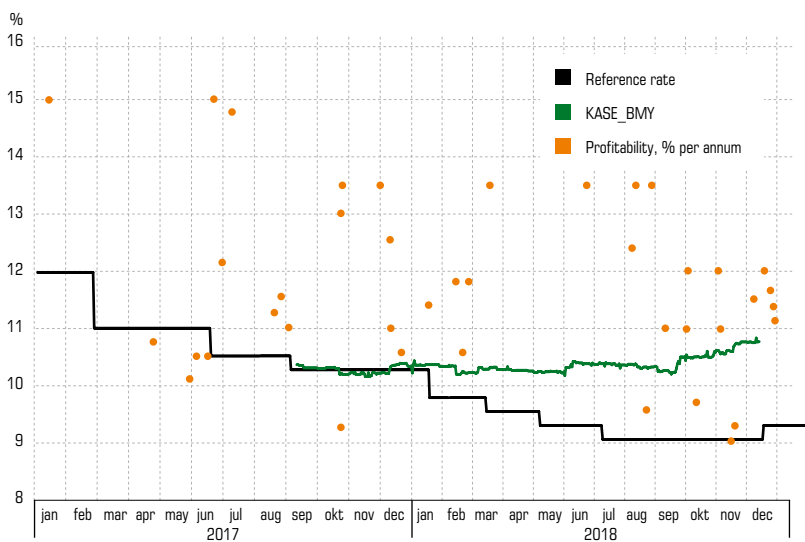
...and New Opportunities for Market Players

In 2016, KASE initiated the project on providing brokers-KASE members with a direct access to the exchange currency market. In 2017, KASE and the National Bank developed a plan, according to which the access of brokers to this market was supposed to be performed in two stages. At the first stage, brokers were already admitted to trading in terms of full preliminary supply of sold and/or payment for purchased foreign currency with restriction of service only for individuals with daily net position not exceeding KZT 100,000. In the second six months of 2017, amendments to appropriate regulatory legal acts of the National Bank and rules of the Exchange were prepared, and work on technical provision of admission of brokers to the currency market started. These preliminary procedures, including adoption of the regulatory documents, were completed in the first half of 2018.

Law of the Republic of Kazakhstan No. 166-VI⁶ dated July 2, 2018 introduced the standards to extend the broker's and/or dealer's rights to certain types of banking transactions, such as opening and maintaining bank accounts of individuals; money transfer transactions; banking borrowing transactions; arranging foreign exchange transactions, except for arranging cash foreign exchange transactions, to the Law of the Republic of Kazakhstan *On Securities Market*.

The main purpose of admission of brokers and their clients to trading in the currency market was to increase a number of trading parties and simplifying the procedure of conversion of currency of brokers and their clients in transactions in the securities market.

MARKET PLACEMENTS OF 2017–2018*



* regardless of placements carried out in accordance with the Program of improvement of financial stability of banking sector of the Republic of Kazakhstan.

Keeping on improving the level of service for trading in foreign currencies, on September 17, 2018, KASE launched trading in Eurobonds with settlement in US dollars. The purpose of this project was to provide an access to trading and settlements in debt securities denominated in a foreign currency, without any additional conversion procedures. Due to this, the listed debt securities denominated in foreign currencies are now traded at KASE at T+0 with settlements in the tenge and at T+2 with settlements in US dollars.

As a result of substantial interest of professional market players, the range of instruments was extended in the markets of foreign currencies and currency swap transactions: in 2017–2018 trading in yuan of People's Republic of China and Russian ruble for the tenge was launched with settlements at T+1 and T+2; in April 2018, trading in currency swap transactions started in respect of CNY/KZT and RUB/KZT currency pairs.

The immediate plans of KASE include launch of swap transactions with settlement period of up to three months and more (long swaps). It is planned to use the advanced risk management system with partial security for open positions.

Good Exchange is an Open Exchange

Over the last years KASE has been actively extending the range of information products. In 2017, the Exchange launched the service for market data delivery to the clients to be used in their internal systems without further distribution. The Exchange data is now provided as a commercial-type product with a right to use it by the clients in making their own products, e.g. indices. Due to IRBIS IAFM closing, KASE began supporting and improving the information terminal IRIS Finance, and KASE news was made as a separate product. The modern information Telegram channel @KASEInfoBot was launched.

@KASEInfoBot is the first KASE product distributed via a mobile messenger (except for IRISMobile application launched by subsidiary IRBIS IAFM in late 2013 and not supported since May 2018). It is a high-demand product – following the results of 10 months of 2018, a number of subscribers of the KASE bot reached 3,000.

In the course of strategy implementation, raising financial literacy concerning financial markets operation and popularizing the stock market, KASE resumed providing analytics and disclosing information regarding its performance and operation of the stock market via mass media and other public communication channels. The information instruments of the Exchange include official announcements in mass media, comments and answers to particular inquiries, interviews and publications, issue of awareness-raising materials, events to promote the stock market and KASE, including via social media. Monthly and extraordinary media briefings conducted by KASE in addition to quarterly press conferences became a new channel of communication with mass media.

In April 2017, TV programs were launched at Atameken Business Channel (currently Atameken TV) hosted by Exchange analysts telling about the exchange trading results, situation in the financial markets, KASE projects and Kazakhstan's

stock market in general. KASE broadcasts are represented by three cycles: daily TV program Stay Tuned, KASE Weekly and Stock Market. Status PRO.

Services and Technologies have Top Priority

Working on improvement of liquidity of shares and attractiveness of the market for foreign investors, in 2016–2017 KASE transferred the most liquid shares (first liquidity class) to the T+2 settlement scheme with net clearing and partial security based on a single limit system; as a partial security for the position the parties may use, along with money, shares of other titles, included in the system of clearing services. The trading party's portfolio is constantly assessed at market value with account of relevant discounts and concentration limits established by the Exchange.

In order to improve the currency market risk management system, in the first half of 2017 the internal regulatory framework, which regulates the risk and default management procedures, was updated. The procedure for interaction between KASE and the National Bank as related to default management was defined, where the National Bank might act as a liquidity provider providing the Exchange with an opportunity to employ resources necessary for default management in a prompt manner. On February 9, 2017, an additional element of risk management system was introduced to the currency market – the limit of party's position opening depending on the amount of a security deposit, which was the Exchange's response to reduced credit quality of certain banks.

However, KASE took it a step further. Considering the multilateral clearing system of the exchange settlements and handling large amounts of money by Exchange members and their clients, KASE introduced the Central Counterparty (CC); CC functions include ensuring stability in the serviced markets through the advanced risk management system and providing the parties with services that enable effective use of funds directed to the market. Since 2012 the Exchange has been fulfilling CC functions in the forward market. On October 1, 2018 the Exchange started fulfilling such functions at the largest exchange market – foreign currencies market. Further, CC functions are planned to be implemented in the remained exchange markets – stock market and money market. Becoming a transaction party for each market player, the Exchange, as CC, guarantees transaction performance. Implemented CC functions contribute to improved reliability and liquidity of all segments of the exchange market.

The purpose of the dynamic reformation of the Kazakhstan's financial market infrastructure is to improve its competitive ability and bring the infrastructure in line with international standards.

In accordance with the Multilateral Memorandum of Understanding signed by the National Bank of Kazakhstan in November 2018 in respect of advising, cooperation and information sharing with International Organization of Securities Commissions (IOSCO), the Exchange plans to conduct the annual self-assessment for compliance with Principles for Financial Market Infrastructures (PFMI)⁷.

Choosing a Strategic Partner

Finding a strategic partner represented by the Moscow Stock Exchange (MOEX) was a historical event for KASE. The Strategic Cooperation Agreement and a number of related documents signed on October 10, 2018 provide for acquisition of trading and clearing systems of MOEX, launch of the Central Counterparty in all the exchange markets, and acquisition of 20% of KASE's authorized capital stock by MOEX by the end of 2019.

The main purposes of cooperation between the two exchanges are the extended access to investors and trading parties to the exchange markets of Kazakhstan and Russia based on a single technological platform; improved reliability of infrastructure and reduced market risks through the development of the central counterparty institution; assistance to KASE public market entry and use of the experience of the Moscow Exchange to conduct the initial public offering by KASE.

The use of trading and clearing technologies of the Moscow Exchange will enable reinforcing the main competitive advantage of KASE business – versatility. Gradual modernization of trading and clearing systems in the stock, money, currency and forward markets will provide the opportunity to introduce new trading instruments and settlement cycles, improve reliability of KASE's IT infrastructure, reduce transaction risks and provide new opportunities for high-frequency trading, minimize transaction costs when operating at KASE trading platforms and allow attracting new players and investors.

The projects of 2016–2018 implemented by KASE in active cooperation with the regulator, AFK and professional players gave a new impetus to the stock market development. The most important is that this impetus and a clearer development line has not only resulted in legislative regulations and concepts, but are also felt by the exchange market actors in daily trading.

In the year of its 25th anniversary the KASE team clearly realizes as never before that the world around changes fast. The current trends spur the Exchange to revision of approaches and business structure, new projects and technologies; and they make existing and potential clients change investment approaches. As trading organizer, KASE is going to create the infrastructure and establish the rules for the trading platform, thereby creating a certain system of elements and connections between such elements depending on the current market environment. This is not only an opportunity, but a heavy responsibility, too. KASE's top priority is to provide the Kazakh companies with real financing arrangements, and investors – with high-quality and convenient instruments of capital management and saving.

The exchange platform servicing the liquid capital market, available in terms of financial costs for all financial market players, using modern fast trading and clearing systems and convenient digital technologies – this is how the Kazakh Stock Exchange sees its future. It is ready to share this future with all its clients and partners.



*Signing the Strategic Cooperation Agreement between
Kazakhstan Stock Exchange JSC and Moscow Exchange PJSC,
2018*



*The Exchange Kazakhstan Forum held as part of the 8th Congress
of Financiers of Kazakhstan, November 2018*

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KASE



Chapter 8

THE MODERNIZATION STAGE

PANDEMIC – A NEW REALITY

THE BENEFITS OF STRATEGIC PARTNERSHIP

THE SYNERGY OF REFORMS

SUSTAINABLE DEVELOPMENT IS NOT JUST WORDS

Chapter 8.

THE MODERNIZATION STAGE

2019–2021 years period was marked for KASE by technological modernization and qualitative expansion of the range of services provided by the exchange to participants of Kazakhstan’s financial market. These tasks were included into the list of key areas of the new development strategy adopted by KASE, having crossed the 25-year milestone of its history. And although this strategy was dictated in the beginning by the capabilities and needs of the financial industry, which was on a post-crisis rise, the pandemic shock that changed the global economic reality made its implementation a very non-trivial challenge.

PANDEMIC – A NEW REALITY

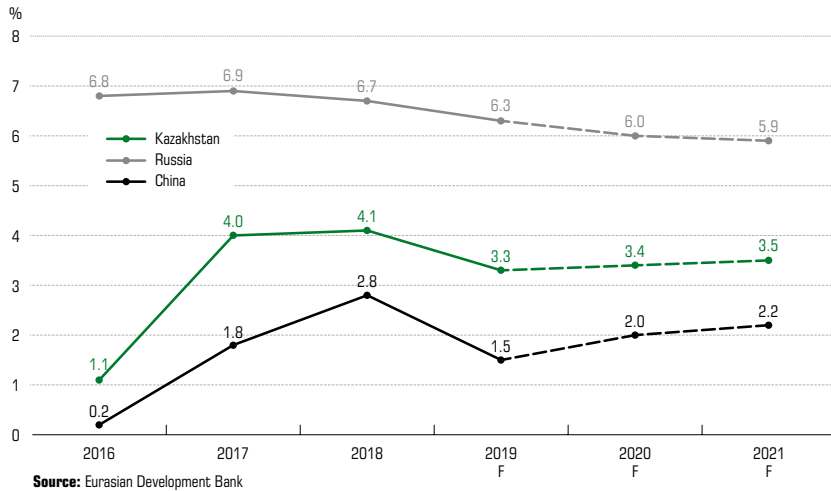
The calm before the storm

By the beginning of 2019 the economy of Kazakhstan completed the recovery rise phase after recession in 2015–2016. At the end of 2018 GDP increased by 4.1%, supported by an increase in oil production and a relatively favorable price environment in the world energy market. For the first time since 2015 the consolidated budget of Kazakhstan was characterized by a surplus against the background of the economic growth and decrease of state spending on banking system rehabilitation compared to 2017. The consumer demand and volume of investments have increased in the context of recovery of the lending activity.

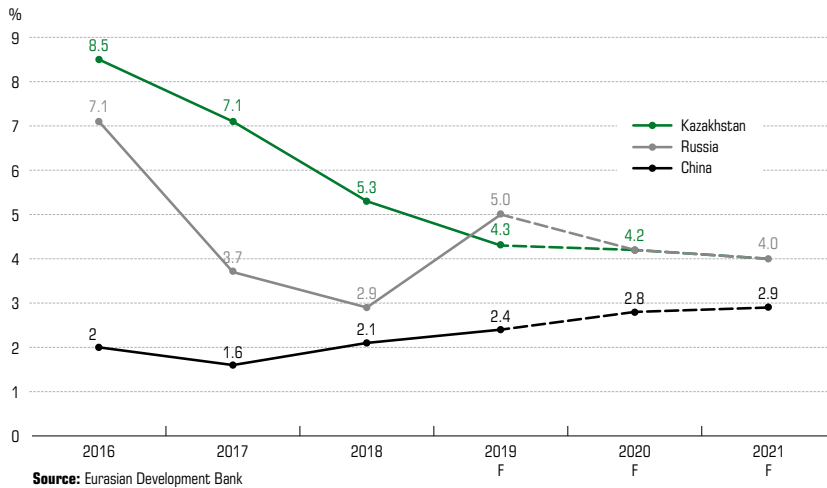
The inflation rate of 5.3% YoY at the end of 2018 was within the target interval set by the NBRK (5–7%), and the base rate during the year varied from 9% to 9.75%. Everything indicated that the monetary policy stance developed by the regulator in previous years will make it possible to keep the inflation within 4–6% in 2019 with a subsequent decrease up to 3–4%.

According to analysts’ forecasts in the coming years the main risks for our economy could arise on the part of the external demand and prices for export primary commodities of Kazakhstan, in the event of more considerable, than was

GDP GROWTH FORECAST FOR 2019–2021



INFLATION GROWTH FORECAST FOR 2019–2021



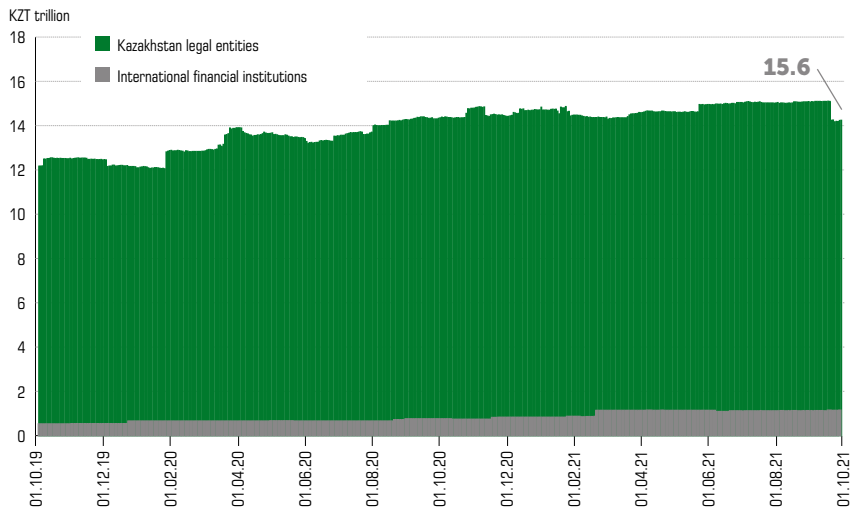
expected, economic slowdown of the main trading partner countries: Russia, China and the European Union.

International stock markets finished the year 2018 with one of the worst growth rates for the recent years amid the US government lockdown and the long-standing trade confrontation between the US and China, the decline in oil prices to \$52 per barrel and forecasts of most agencies about a slowdown in global economic growth.

However, despite the uncertainty of external economic conditions, Kazakhstan's stock market developed with a positive dynamics in 2019. The volume of trades in securities increased by 8.5% and amounted to KZT5.3 trillion. The stability of the key rate influenced the rates of the money market and led to a recovery in borrowing by the Ministry of Finance, as well as to emergence of new borrowers in the person of international financial institutions. The volume of corporate bonds offering in the market came close to KZT2 trillion, and the total volume of funds raised through the exchange touched record highs of KZT3.9 trillion.

The equity market capitalization increased to KZT17.2 trillion. The inclusion of shares of 16 foreign companies, namely, Apple Inc., Facebook Inc, Microsoft Corporation, Starbucks Corporation, Ford Motor Company, Intel Corporation, The Coca-Cola Company, Nike Inc, Pfizer Inc, Tesla Inc, Yandex N.V., Tiffany&Co, ExxonMobil Corporation, Norilsk Nickel MMC PJSC, LUKOIL PJSC and Novolipetsk

THE FACE VALUE OF OUTSTANDING CORPORATE DEBT



Metallurgical Plant PJSC in the KASE official list became a notable event of 2019 for equity securities segment.

The volume of trading in the currency market and in the segment of currency swap transactions decreased due to reduction of volatility. Nevertheless, the market for direct conversion operations on currency pairs of the main trading partners of the Republic of Kazakhstan targeted by the exchange grew quite dynamically.

The decision to establish an independent authority, the Agency for Regulation and Development of Financial Markets, was a landmark event from the point of view of the regulatory environment. The relevant act was signed by the Head of State, Kassym-Jomart Tokayev on November 11, 2019. The area of responsibility of the Agency covers surveillance of the financial sector, including the stock market, while the National Bank has focused on monetary policy and cooperation with the government since January 1, 2020.

*“At this stage of development of the financial sector the most important was the issue of vesting the functions on the development and regulation of the financial industry to a separate state body. We were concerned about the issues of increasing the stability of financial institutions and rehabilitation, taking measures to enhance the role of the sector in financing the economy. There was much concern about further digitalization of financial services, protection of consumers and improvement of financial literacy”, recalls **Madina Abylkassymova**, the Chairman of the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market.¹*

COVID-19 “Black Swan”

Nothing warned about severe shocks at the beginning of 2020. At the end of 2019 the inflation made up 5.4%, and GDP growth made up 4.5%. The NBRK continued to stick to the national currency floating exchange rate arrangement; its fluctuations remained in the range of 373.56–390.13 Tenge per US dollar. The volume of lending to the economy by the banks which successfully passed the Asset Quality Review (AQR) increased by 5.9% to KZT13.9 trillion. World stock markets, including Kazakhstan’s market, were in a moderate growth, keeping a close watch on trade relations between the US and China and anticipating the start of the annual reporting period.

However, at the end of February 2020, the coronavirus panic began spreading and reached a peak in mid-March, against the background of a lockdown in many countries and shutdown of a number of sectors of the economy due to the introduction of quarantine restrictions.

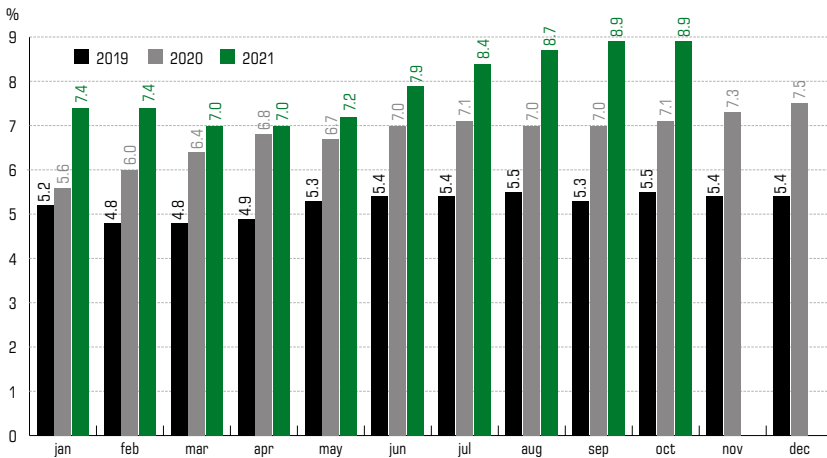
Due to disagreements between Russia and Saudi Arabia and OPEC+ failure to agree on new terms of the transaction, the oil price just in a few days dropped from \$50 to \$19.33, and as a result, the USD/KZT exchange rate soared from 380

to 450 Tenge per Dollar. In an attempt to keep this growth down the National Bank raised the base rate to 12%. Since March 16 a state of emergency was declared in Kazakhstan. Entry and exit from the country were restricted, quarantine or other restrictive measures were introduced in all regions, the activities of business, trade, culture and other public gathering places were suspended.

By April, most governments had moved to smooth reduction of rates and expanding the unprecedented set of support. In Kazakhstan, the share of incentive measures in relation to GDP was one of the highest in the post-Soviet area and made up 8.7%, or KZT5.9 trillion. Launching new and expansion of existing soft loan programs for entrepreneurship, such as "Business roadmap 2025" and "Economy of Simple Things", granting to borrowers grace periods on loan repayment, allocating funds for housing and utility development under the "Nurly Zher" program, social support measures for the population, including direct financial assistance – all this made it possible to reduce the degree of tension in the society and the economy. As a result, on April 6, 2020, the National Bank reduced the rate from 12% to 9.5% and on July 21 – to 9%, a level at which it remained until the end of the year. In fact, government support measures significantly mitigated the consequences of the pandemic on both the economy in general and the stock market in particular.²

On the other hand, a sharp increase in costs of fighting the pandemic resulted in higher levels of borrowing by the Ministry of Finance in the domestic market,

THE CONSUMER PRICE INDEX IN 2019–2021, % TO THE RELEVANT MONTH OF PRECEDING YEAR



Source: the Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan

which stimulated the growth of the primary market for government securities on KASE. In order to encourage investor interest in MEKAM, the Ministry of Finance made changes to the schedule for issuing securities for 2020, having increased the volume of issue of short-term securities with the maturity periods from one to three years from KZT45 billion to KZT1 trillion. The National Bank, in turn, refused to issue its longer notes with the maturity period of one year in order to send liquidity to the government securities of the Ministry of Finance to finance the budget deficit.

The results were not long in coming and banks became interested in the “short” securities of the Ministry of Finance, since their earning capacity has increased significantly. Trading volume in the sector of government securities initial offering increased by 2.6-fold at the end of 2020 (from KZT1.4 to KZT3.7 trillion). More than 70% of this volume, or KZT2.8 trillion, accounted for government securities offering by the Ministry of Finance. This was an unprecedented event for Kazakhstan’s market. Another KZT963.2 billion were raised by local executive bodies, which directed these funds for the implementation of state and government programs in order to finance housing construction. Quasi-public companies, also actively participating in incentive measures programs, push upwards the trading volume in the corporate bond sector. They accounted for 91.0% of the total volume of borrowings in the corporate bond market, which amounted to KZT2.2 trillion.

In doing so, KASE, acting as the main channel for capital redistribution, made its contribution to a suitable way out of the current pandemic situation. Having faced the need to restructure its activity in accordance with quarantine restrictions, the exchange, nevertheless, ensured the availability of its systems and services to all market participants, including using remote access technologies.

Starting from the second half of 2020 the oil prices proceeded to growth as soon as OPEC+ countries reached an agreement after lengthy discussions to cut the production. The prices for the most metals soared to historic maximum rates amid increased demand, mainly from China, which was the first to get through the pandemic and seek to recover the economy as soon as possible. The combination of positive external factors led to an increase in the prices of the most shares of the representative list of the KASE Index.

The investment disposition in foreign markets continued to grow in autumn and reached a peak in October-November. As far as the majority of emerging market countries demonstrated stability, the carry trading became more active. The US market was characterized by the increase of the earning capacity of 10-year treasury bonds indicating that investors were choosing more risky instruments. All this had a positive impact on KASE – at the end of the year, despite the decline of Kazakhstan’s GDP by 2.6%, the inflation increased to 7.5%, and wholesale and retail trade decline, the KASE Index managed to show a relatively good growth of 13.2%. And if we count from the “shock” minimum on March 16, when it fell to 13%, the Index recovery made up 30.2%. All this created a fundamental platform for growth in 2021.

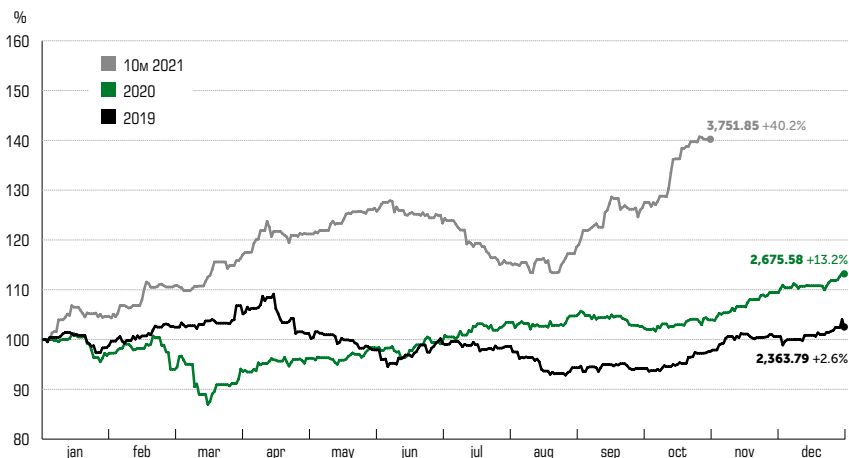
A step towards “digital” decade

In 2021 the economy of Kazakhstan demonstrated a stable recovering dynamics. According to the totals of 9 months GDP growth made up 3.4%. This happened amid the growth of world prices in commodity markets (the Brent oil price increased by 65% by October and made up on average \$69 per barrel) and easing of quarantine restrictions. In addition to existing anti-crisis programs, the initiative of the President of the Republic of Kazakhstan Kassym-Jomart Tokayev on the early withdrawal of pension savings of UAPF contributors to improve housing conditions and pay for treatment had a serious economic and social effect. By the end of October 2021 over a million people in Kazakhstan have taken advantage of this opportunity, applying for a total of almost KZT2 trillion.³

If we look at the situation in the global stock markets, they entered 2021 with the expectation of opening and restarting of economies due to widespread vaccination, monetary policy easing and adoption of new stimulus measures. The markets consistently updated the historical maximum rates, while a large amount of liquidity contributed to the fact that any drawdown was immediately bought out and the growth continued.

Kazakhstan’s market was no exception and KASE index updated its historical maximums for five consecutive months, afterwards slightly decreasing by the end of summer. The increase continued in September and reached a peak on October 26, when the market closed at 3,765 points. The growth by this date since the beginning of the year amounted to 40.7%, which is the maximum value for the past 20 years.

KASE INDEX IN 2019–2021



Not only the overall bullish determination of the markets played an important role in this achievement, but also the digital transformation of brokerage services launched at the suggestion of the Agency for Regulation and Development of Financial Markets as early as in 2020. The accessibility and simplicity of account opening and trading which was ensured by the brokers and other market participants thanks to digital technologies became a catalyst for the growth of interest in the market from the side of retail investors.

“Entry of a retail investor to the market is an important trend. We have a considerable reserve for opening new accounts, since the penetration of the brokerage business in the retail segment is still small. My personal opinion is that the number of retail accounts will increase at least 2–3 times in the next year or two. The number of people in Kazakhstan who have sufficient income to invest in securities is much more than one million. And all this is just a beginning of a great development of the retail class of investors,” forecasted Farkhad Okhonov, the Chairman of Management Board of Halyk Finance JSC.⁴

In just 10 months of 2021, more than 73 thousand new accounts were opened by individuals in the CSD accounting system, while for the entire previous year the increase was only 17 thousand. The coronavirus pandemic intensified the introduction of digital technologies and changed the attitude of people around the world to digital services, and people of Kazakhstan are no exception.

This merely confirmed the relevance and timeliness of a huge work on technological and IT-modernization of the exchange which has been accomplished by KASE over the past three years.

THE BENEFITS OF STRATEGIC PARTNERSHIP

Preparation to fundamental technological breakthrough at KASE started in 2016 when the Board of Directors of the Exchange delegated its specialists to review the set of IT decisions, determine potential suppliers and expenses on purchase and implementation of new systems in accordance with selected KASE development strategy. Back at that time technical modernization in combination with marketing activity and service-oriented approach were considered as a key tool to improve capitalization and liquidity of the stock market, as well as the efficiency and competitiveness of KASE’s business.

In this connection in 2016–2017 KASE considered the proposals from a number of famous suppliers of IT platforms for exchanges, such as Millenium, Euronext, Nasdaq, etc. Taking into account the similar character of the stock markets of Kazakhstan and the Russian Federation, as well as the benefits of their interaction, the choice fell on the Moscow Exchange. A positive argument was

the fact that MOEX, like KASE, is a universal exchange operating, among other things, foreign exchange and money markets. The analysis of MOEX trading and clearing systems carried out according to 234 criteria demonstrated that they meet the KASE requirements to 81%. In addition, MOEX successfully implemented a risk management system in its stock markets according to the Central Counterparty (CCP) scheme, and the KASE management counted on the same successful application of this experience in their markets.

On October 10, 2018 KASE and MOEX signed the Strategic Partnership Agreement, and IT modernization of the exchange through transition to trading and clearing systems of Moscow Exchange PJSC and launching the Central counterparty services were fixed as key objectives of implementation of new KASE development strategy for 2019–2021 which was adopted at the beginning of 2019.⁵

The implementation of new trading and clearing technologies based on MOEX systems should improve the operational reliability of the stock exchange infrastructure, decrease operational risks of trading participants, expand the range of financial instruments available for trading and modes of making the transactions, provide opportunities for the development of high-frequency trading and direct connecting the foreign brokers, as well as “second-level” participants of KASE members through SMA access (sponsored market access).

The practical phase of KASE technological retooling started from the purchase of three trading and clearing systems from MOEX: two ASTS+ for the foreign exchange and stock markets, and the third trading platform, Spectra, intended for the derivative instruments market. The KASE project team, having carefully analyzed the processes in the trading systems used at that time, set the terms of reference, which became the starting point in the updating and preparation of MOEX systems for their installation on KASE.

ASTS+ in the stock market...

The largest and most difficult volume of work fell to the implementation of ASTS+ for the stock market. The infrastructure of the Russian market and Moscow Exchange market are considerably different from the infrastructure of Kazakhstan’s market and KASE due to the differences in the laws of two countries, adopted trading, clearing and settlements procedures. So, for example, in Kazakhstan’s stock market, trading accounts are segregated for each client of a broker – a member of the exchange, the most demanded instrument of the repo market has always been a repo with a basket of securities, and the confirmation of transactions by custodians was also required. Things were arranged differently on MOEX. Taking into account the specifics of Kazakhstan the developers had to modify the existing modules of the system, and create some units virtually from scratch.

A wide range of issues resolved in the process of developing functional targets for MOEX concerned Kazakhstan’s laws, therefore its norms were adapted

to the capabilities of new trading systems in parallel together with the authorized body. At the same time, the exchange team trained market participants on the way of operation of the new system.

KASE's IT specialists have completed a great job to align internal systems, develop "connecting modules", linking the exchange back office with MOEX systems. The new pattern of the trading and clearing system also required a restructuring of interaction with the Central Securities Depository and revision of its systems. As they were ready, testing was carried out with the participation of trading participants who actively integrated their systems with the new KASE systems.

The complex and challenging target of introducing the CCP functions for all stock market instruments required the division of the ASTS+ launch into two stages – the release.

At the first stage KASE put into operation the new ASTS+ trading and clearing system and started performing the functions of the CCP for shares, securities of investment funds and ETF with settlements in Tenge, as well as Eurobonds and depositary receipts with settlements in US dollars. The launch of "direct" operation of the release took place on December 3, 2019 and by January 1, 2020, 8.5 thousand transactions with a total of more than KZT30.1 billion were made in the new trading and clearing system of the stock market with the participation of 20 members of the Exchange.

The second release of the new trading and clearing system started on August 3, 2020 and completed the transfer of the repo and securities trading market to ASTS+ that were not included in the first release. This allowed KASE to perform the functions of the Central Counterparty for all financial instruments of the stock market, including government securities, corporate bonds, as well as money market instruments – repo transactions with individual securities and GS and CS baskets. The netting of participants' positions in the sectors of purchase and sale of securities and repo was introduced for the first time in the regulated market of Kazakhstan, which significantly reduced transaction costs after trading, and also optimized business processes. In addition, trading in transactions without the CCP the settlements for which are carried out on a gross basis was transferred to the new trading and clearing system.

Since the date of the second release the average daily volume of trading all stock market tools accessible in ASTS+, reached KZT27.6 billion, and taking into account repo operations – KZT473.5 billion. As of November 1, 2021 trading in securities of 754 titles started in ASTS+, including 208 titles of securities that were admitted to transactions with the Central Counterparty on the basis of a partial security.

Commenting on the results of the project Igor Marich, Managing Director for Money and Derivatives Markets, Member of the Board of MOEX noted: "Today, the stock market participants expect high performance, reliability, speed and flexibility from trading and clearing systems of exchanges. We believe that MOEX technologies meet these challenges. We are proud that KASE made

the decision to implement the transition to a new trade and clearing solution with us. These technologies are a good basis for building a single financial market within the EAEU.⁶

... and currency market

Being at the stage of completing the ASTS+ implementation in the stock market, KASE proceeded to modernization of trading and clearing technologies of a currency market. The specific feature of this project was already operating CCP introduced in this segment in autumn 2018.

The transition to the new ASTS+ system was not difficult for the exchange and trading participants in terms of the processes and order of trading, clearing and settlements, since they did not fundamentally change, only the technologies on which they were based changed. On the other hand, the project had to be implemented under the conditions of quarantine restrictions, and communication of the working group was carried out in the form of online conferences. It was necessary to simultaneously maintain the systems that were in force at that time, ensure the introduction of a new one, and also adapt to work in a remote mode.

As it is remembered by the developers, the job on transferring all unenforced transactions from the old trading system of the NEXT currency market to the new ASTS+ turned out to be quite challenging one, since on the day of launch the participants should see all their positions opened on previous days in the new system. This approach was fundamentally different from the approach that was used when launching the ASTS+ for the stock market. In that case all the positions opened in the old trading system were simply enforced in it, and new transactions were executed in the new ASTS+. It was not possible to use such an approach in the currency market, since the netting of positions opened at different times had already been introduced here, and its break would lead to a break in the positions of traders. The developers found a way out of the situation and developed a special algorithm to transfer transactions and balances of participants' positions to the new system.

The proposed solution has worked out and the exchange has successfully commissioned the "currency version" of the ASTS+ on November 30, 2020. Starting from this date, the trading in all 38 financial instruments, including five currency pairs (USDKZT, RUBKZT, CNYKZT, EURKZT, EURUSD) with different settlement periods (T+0, T+1 and T+2), currency swap transactions against the US Dollar, Russian Ruble, Chinese Yuan, Euro with settlements in Tenge and deliverable futures for the Dollar/Tenge rate, started to be carried out in the ASTS+. The new trading and clearing system provides for all trading modes which were earlier used for trading in foreign currencies on KASE. In addition, negotiated trades became available in the currency market, in which it was possible to make direct transactions in the same way as in the over-the-counter market. This means that transactions and orders on the basis of which they were made are

seen in the trading system only by the agreed parties. A unified netting and risk management system of KASE as the CCP in the currency market started to be applied to transactions made in various modes. In addition, the ASTS+ expanded the range of derivative financial instruments available for trading in the currency market and significantly improved the risk management system.

"KASE has made a considerable breakthrough in terms of its technologies development. The exchange previously developed its own unique technologies that allowed trading in a variety of instruments on KASE and operated with a large stock of productivity. At the same time, under the previous trading system, the internal competencies were insufficient in the field of structuring the Central Counterparty's risk management processes. The main part of the exchange systems modernization has been completed, and currently we are working on the introduction of new products and services. For example, we are talking about CPC (clearing participation certificate) in the repo market, creation of trade and clearing links between our exchanges," noted Idel Sabitov, Deputy Chairman of the Management Board of KASE at that time, responsible for implementation of new trading and clearing systems.⁷

SPECTRA for derivatives market restart

The finalizing stage of the process of transition of KASE trading systems to MOEX trading technologies was the introduction of the new SPECTRA trading and clearing system in the derivatives market. In this segment of Kazakhstan stock market the CCP mechanism has been operating for ten years, and therefore the system was implemented under the principle of minimal modifications to meet the needs of KASE or lack thereof. Moreover, taking into account a wide range of options offered by SPECTRA for derivative financial instruments operations the underlying assets of which are shares, bonds, indices and currency pairs, KASE hoped that it would help to restart the derivatives market. SPECTRA ensures a required level of risk management, since it includes the levers to manage market and credit risks. The merger of the Central Counterparty and the trading and clearing system made it possible for traders to actively manage the positions in large volumes, but at the same time risk management tools significantly reduced the credit risk and the default risks.

On July 7, 2021, KASE successfully transferred the derivatives market to SPECTRA trading and clearing system. The futures contracts for the US dollar rate, the KASE Index and the rate of a number of shares titles without delivery of the underlying asset became available for trading in the new system. The opportunities of the system made it possible to expand subsequently the range of futures for other underlying assets, as well as introduce options, ensuring the interests of a wide range of participants on the basis of a reliable and high-performance trading and clearing system.

The Exchange stands guard over fulfillment of obligations

The introduction of new trading and clearing systems laid the technological foundation for implementation of the second important direction of the Development Strategy for 2019–2021 – the launch of CCP services in all stock markets.

The Exchange has already had some experience in providing such services: it has been acting as the CCP in the derivatives market since 2011, and since October 2018 – in the currency market, including the market of short-term currency swaps. However, in order to ensure the completion of settlements for all financial instruments traded on the exchange, create conditions for launching a netting mechanism in the stock market and in the repo sector, and launch multi-tool transactions support (the so-called single limit) it was required to have an appropriate IT infrastructure. And the launch of the second release of the ASTS+ trading and clearing system on August 3, 2020 provided such an opportunity.

At the same time, not only KASE, its strategic partner MOEX and market participants, but also the financial system regulator, the National Bank, was actively involved in the activity on launching a new infrastructure element, the CCP, since such step required the adoption of new rules for regulating the trading activities and the activities of the CCP.

“The National Bank indisputably supported the creation of the Central Counterparty function. The introduction of the Central Counterparty on KASE increased the guarantees for fulfillment of all obligations and requirements in relation to concluded transactions. Netting of the participants’ positions for all types of stock market transactions, including the repo sector has been introduced for the first time in the regulated market thanks to the new trading and clearing system. This increased the efficiency of liquidity management for members of the Exchange, helped to reduce transaction costs, and in the future will increase the liquidity of our market”, noted Aliya Moldabekova, Deputy Chairman of the NBRK, Chairman of the Board of Directors of KASE.⁸

The introduction of the CCP in all stock markets made it possible for the traders to estimate only the KASE risk profile as a single contractor when opening positions on one or another market and this promotes the growth of the limits for the corresponding KASE market. Another important factor for the traders was the introduction of clearing by means of netting for obligations with a common settlement date and the same financial instruments. In so doing, it was no longer required to enforce each previous transaction before concluding a new transaction during a day. All this, along with the introduction of multi-tool transactions support significantly increased the efficiency of asset management,

reduced the costs of brokers and their clients when operating in the stock market, and should inevitably have a positive effect on the liquidity of traded instruments.

*"The introduction of trading and clearing system and CCP represents a significant reduction of the risk of nonpayment being the main risk when making "blind" transactions. The issue of possible contractor's failure to comply with its obligations before the trader, as such, is no longer raised", assures **Sholpan Ainabayeva**, Chairman of the Board of SkyBridge Invest. "The issues of violation of transactions were resolved by arbitration committees before. This took time and negatively affected transactions. Now all questions are settled thanks to the availability of the CCP, when the exchange independently will regulate this risk through the clearing system. This risk no longer exists for bona fide traders and makes it possible for them to deal with the main thing – to enter into transactions".⁹*

It is clear that in order to provide to all market participants the guarantees for enforcement of transactions, the CCP itself, represented by the exchange, had to build adequate "lines of defense". In particular, the system of default management and disposal of open positions of traders who failed to fulfill their obligations to the CCP was improved (and for some groups of instruments it was developed from scratch). The system of risk-parameters determination and their adequacy monitoring and timely revision has been developed. The CCP's asset management system and the rules for selecting liquidity providers to attract assets required for fulfilment of obligations were revised. In addition, clearing funds were formed both from the funds of clearing participants of these markets, and from funds specially allocated by KASE, in order to cover market risk under the conditions of heightened volatility upon liquidation of default participants' positions in each stock market.

The exchange itself gained a considerable competitive advantage in the market thanks to modernization and introduction of the CCP. On the one hand, a systematic approach to credit and market risk management contributes to an increase in the level of trust and an increase in the number of participants, especially foreign investors, for whom the presence of the CCP is a primary requirement for entering the local market. On the other hand, the CCP services have become a new and very promising line of the business:

*"For example, according to our estimates, the execution of Central counterparty and clearing organization functions in all markets by the exchange resulted in increased volume of clearing fees by 62% for 2020", analyzes the rates **Alina Aldambergen**, the Chairperson of the Management Board of KASE. "At the same time it is important to keep in mind that we had an illiquid market for a long time. Subsequently the liquidity of some instruments started to grow. Thanks to the CCP, it can increase even more. Let me specify the advantages of the new ASTS+ trading and clearing systems: high reliability – the availability of IT systems makes up 99.99%, performance – the speed*

of processing is about 30 thousand transactions per second, functionality – a wide range of methods and rules of trading in various instruments is supported. In July 2021 the omnibus account mechanism was introduced, that is, trading on a single broker’s account without keeping separate customer accounts. This is a standard practice for foreign investors.”¹⁰

Focus on “digital” services

The implementation of projects on introduction of new trading and clearing systems and the launch of the Central Counterparty in all KASE markets were the key but not the only element of technological modernization of the exchange. The transition to new IT platforms implied a huge layer of work associated with a general increase in effectiveness and digitalization, significant modernization of the back office, automation of many business processes, including the new ones. The team of the stock exchange sometimes had to work seven days a week, but it was driven by enthusiasm and a very strong motivation to implement a large-scale project having a systemic impact on the stock market infrastructure, and significantly changing the post-trading procedures associated with clearing and settlements.

*“The employees of key departments and IT specialists of KASE accomplished a great job to align internal systems of the exchange – the back office, website, IRIS, etc. – with new trading and clearing systems, debugging the mechanism of interaction with the Central Securities Depository. The introduction of the CCP required the opening of new CCP sections on the accounts of depositors in the Central Securities Depository, a change in the business processes of the traders”, remembers **Idel Sabitov**.¹¹*

The IT modernization also provided for the digitalization of the exchange’s services related to the listing of securities and the disclosure of information by members of the exchange. In particular, the is2in system of electronic document circulation between the exchange, its members and issuers, which applies electronic digital signature, was further developed. The exchange also made progress in the area of information products distribution. The functionality of the @KASEInfoBot information channel in the Telegram application was significantly expanded, and a browser version of the IRIS information terminal was implemented. In 2020, a service to pay for the access was launched to view the trades in real time on the exchange’s website via acquiring. This innovation allowed users to make payments using bank cards, reducing to a minimum the time required to gain access to the service.

In general, the focus on service-oriented approach through automation and digitalization of services became one of the main trends in KASE’s development for 2019–2021. The products of the exchange were constantly improving, and their functionality expanding.

THE SYNERGY OF REFORMS

The objective on development and improvement of attractiveness of Kazakhstan's stock market declared in 2018 by the Government and the National Bank¹² as one of the most important priorities, in 2019–2021 resulted in the implementation of a number of institutional initiatives and systemic projects. The establishment of the Agency for Regulation and Development of Financial Markets with a focus on liberalization of the access to the market for new investors and issuers, the further development of the international line with Clearstream, the reform of money market indicators – all this helped KASE to make serious progress in increasing liquidity and depth of the stock market.

More liquidity for the government securities market

Thanks to the joint efforts of the NBRK, the Ministry of Finance and KASE in 2018 Kazakhstan's government securities were included in the list of securities listed on Clearstream international system. The settlement scheme for exchange transactions with GS in the secondary market and during the placement of notes of the National Bank was changed from T+0 to T+2. Since August 2020, the international settlement line has been upgraded to "delivery versus payment" (DVP), when payment for delivery is carried out simultaneously with the transfer of securities, what reduces risks for the parties involved and complies with best international practice.

"DVP allows reducing the risks when "entering" the list of government securities of Kazakhstan, and in the conditions of competition for capital flows this is a definite plus for us in comparison with similar markets... From technical point of view we became even more integrated with global financial markets. Attraction of external investment in government bonds reduces the cost of borrowing for the state, expands funding sources and promotes improvement of market liquidity and diversification of the investor base. Integration with international depositories and global custodians has a positive impact in terms of positioning the domestic market", noted Aliya Moldabekova, Deputy Chairman of the National Bank.¹³

More comfortable conditions for foreign investors to participate in the Kazakh government securities market led to the fact that by the middle of 2021 the share of non-residents in the gross turnover of the secondary market already approached a point of 8% (KZT97.8 billion) compared to merely 0.1% (KZT745.6 million) in 2019.

The second important focus was the activity of the Ministry of Finance on enlargement the existing issue of its securities with a simultaneous reduction in their number. In 2020–2021 the Ministry of Finance enlarged 26 issues and issued 15 new issues (4 issues in 2020 and 11 in 2021) for a total amount of KZT4.8 trillion. At the same time, the amount of individual issues exceeded

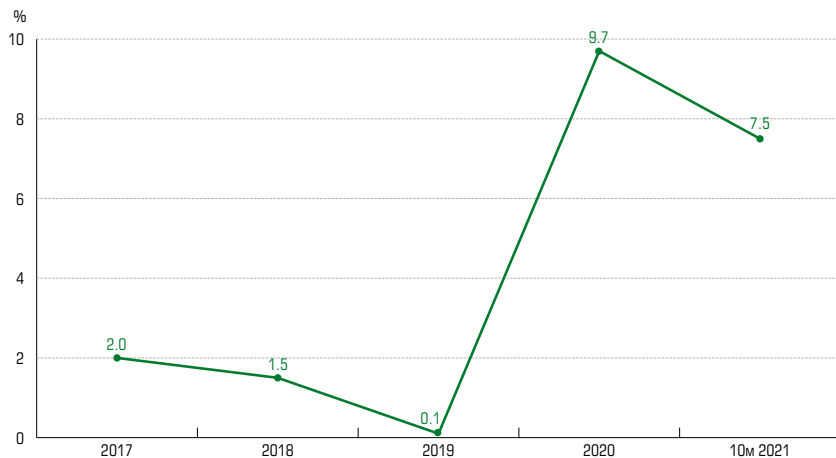
KZT500 billion. All these placements were carried out with different maturities within 10 years, forming a more representative GS yield curve and ensuring the opportunity to quote such enlarged issues for large global players. In turn, as already was mentioned, the National Bank stopped issuing annual notes from the middle of 2020, displacing investor demand for GS of the Ministry of Finance.

In order to increase the liquidity of the secondary market of government bonds, KASE, in turn, introduced a program for market makers, which allowed them to use several schemes for announcing quotations and maintain quotations of various volumes and spread based on the targeted categories of investors. In total, three market makers have been operating on KASE by the end of 2021, supporting the quotations for 20 Kazakhstan government bonds.

In Q4 2019 KASE introduced a new methodology for plotting the GS yield curve complying with international standards. During 2020, KASE has been promoting the method, organizing explanatory work with market participants and providing additional data to interested market participants on the level of GS earning yield, thereby forming a benchmark of risk-free yield for the Kazakh market.

The announcement of the JP Morgan Index Management Team of the inclusion of Kazakhstan's debt market in the Watch list in the middle 2021, which includes applicants for entering the global emerging markets bond index became a confirmation of the efficient activity of the NBRK and the Ministry of Finance in plotting the yield curve and increasing the liquidity of the domestic GS market. This event was a significant step towards the globalization of the Tenge and assets in national currency.

THE SHARE OF NON-RESIDENTS IN THE SECONDARY MARKET OF KAZAKHSTAN GS, % OF THE GROSS TURNOVER



Reform of money market indicators

Money markets and their key indicators have always been a tool to determine the cost of borrowing and a guide for creditors in offering products that meet the needs and expectations of customers.

In June 2018 in order to support the development of the financial market and improve its key benchmarks the National Bank created a working group which included representatives of the European Bank for Reconstruction and Development, KASE and leading financial institutions of Kazakhstan. The intention of the global financial industry to completely refuse the LIBOR rates by 2024 played a significant role in its creation.

After a detailed analysis of possible indicators, the National Bank announced in October 2019 that TONIA indicator (one-day repo rate with government securities which has been calculating by KASE since the end of 2001), the calculation procedure of which will be changed and brought in line with the advanced international standards. This will strengthen the benchmark and support the development of longer-term instruments, both cash and derivatives.

Upgrading of the TONIA methodology took about a year and coincided with the introduction of the new trading and clearing system in the money market and the related significant changes in the instruments and procedure for the repo market functioning. This, to a certain degree, made it difficult to carry out test calculations and forecasting the depth of this instrument. At the same time, it was necessary to approach the definition of the indicator methodology and the basis for its calculation as carefully as possible.

At the end of December 2020 KASE announced a change in the procedure for calculating TONIA, and thus the goal of creating a risk-free benchmark in the money market of the Republic of Kazakhstan complying with the best international practices and increasing the transparency of its calculation was achieved.

"In the process of upgrading the methodology for calculating the TONIA indicator, within the framework of the working group, the exchange carried out test calculations of this indicator, adaptation of its information systems to the new calculation methodology, as well as provision of statistical support to the members of the working group for making the most balanced decision. At present, KASE has started calculating and publishing the updated TONIA indicator as its administrator", commented Natalya Khoroshevskaya, Deputy Chairperson of the Management Board of KASE.¹⁴

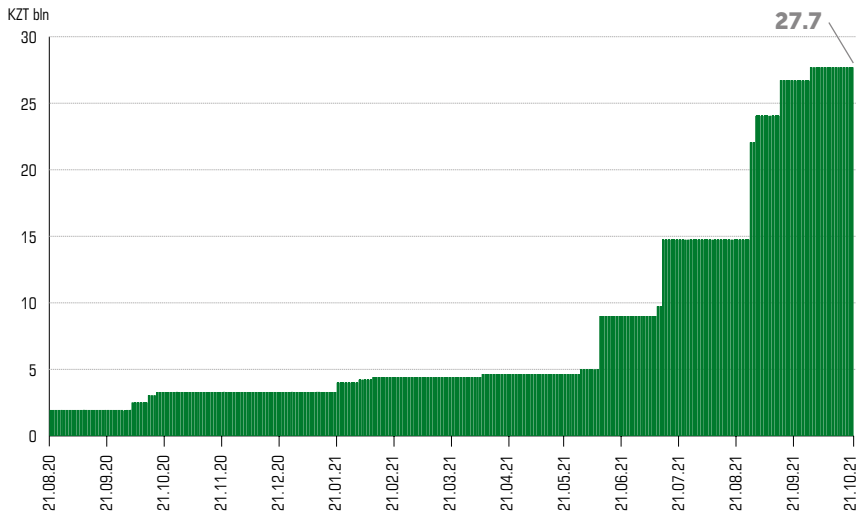
In 2021 KASE developed and implemented TONIA composite indices for 1, 3 and 6 months to provide more comfort for the users of this indicator and to form an idea of its change in the standardized terms. And the indicator, which is calculated according to the old TONIA algorithm in real time, and not based on the results of the day, was given a TRION name.

Steps towards the retail investor

A striking market trend in 2020–2021 was the progressive growth of the retail investor base. This was mainly possible thanks to the active work of the new security market regulator, namely the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market. Changes in the specific legislation, continued and initiated by the Agency for Regulation and Development of the Financial Market stimulated the interest of the country's citizens in investing in the stock market, also due to the appearance of new attractive instruments on the stock exchange.

For example, from the beginning of 2020 microfinance organizations in Kazakhstan entered the list of licensed entities subject to regulation by the Agency for Regulation and Development of the Financial Market, and they were authorized to raise funds through stock markets. In August of the same year, OnlineKazFinance Microfinance Organization LLP initiated the first issue of two-year bonds which were placed to the amount of KZT3.3 billion at 19% per annum. Among the main categories of investors this issue raised the greatest interest among individuals thanks to such rate of return and made up 69% of all purchased bonds. By the end of 2021, seven MFOs had already entered the exchange which issued bonds in the amount of KZT2 million to 10 billion with maturities of 2–5 years and coupon interest rate of 6% to 20% per annum. It is worth noting that the secondary securities market for this type of issuers demonstrated a high interest among individuals and their share in the secondary market reached 28% of the gross turnover of trades in MFO bonds.

NOMINAL VALUE OF THE DEBT OF MICROFINANCE ORGANIZATIONS IN THE TURNOVER



NEW REGULATOR

The Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market is a state body established to ensure a proper level of protection of the rights and legitimate interests of financial services consumers and promote the stability of the financial system and the development of the financial market. The Agency established in early 2020 by the Decree of the President of the Republic of Kazakhstan dated November 11, 2019 "About further enhancement of the system of public administration of the Republic of Kazakhstan" was defined as a legal successor of the rights and obligations of the National Bank in accordance with the transferred functions and powers. The main tasks of the Agency:

- Regulation and development of the financial market, including the

establishment of standards of activity of financial organizations, creation of incentives for improvement of corporate governance of financial organizations;

- Monitoring of the financial market and financial organizations to preserve the stability of the financial system;
- Concentrating oversight resources on the financial market areas mostly exposed to the risks to ensure financial stability;
- Ensuring a proper level of protection of the interests of consumers of financial services, completeness and accessibility of information for consumers about the activities of financial organizations and financial services provided by them, as well as increasing the level of financial literacy and financial accessibility for the population.



Visit of M.Ye. Abylkassymova, the Chairman of the Agency of the Republic of Kazakhstan for the Regulation and Development of Financial Market, to KASE, 2020

The unit investment trust market has also become active at KASE. The main focus here was put on increasing the accessibility of unit investment trusts' securities among the population. The restrictions on the admission of venture funds' securities to the stock exchange were removed and the repurchase of units was allowed on the stock exchange. The management companies were provided with the conditions to fulfill market maker functions for the securities of their own UITs and the opportunity to form a more flexible investment strategy through expanding the list of permitted financial instruments and liberalization of the investment limits. Such liberalization inspired broker organizations to enhance the activity on restoration of the interest to these instruments among retail investors. If at the beginning of 2020 only 11 instruments were offered on KASE's market in the securities sector of investment funds, namely 3 ETFs and 8 UITs, then as of November 1, 2021 their list has expanded to 6 ETFs and 17 investment fund instruments. This happened due to the inclusion of UITs managed by Halyk Finance JSC, BCC Invest JSC, First Heartland Jysan Invest JSC, East-West LLC, as well as three ETFs for global shares of gold mining companies and companies from the clean energy and water resources sector.

The joint activity of brokers and the Agency for Regulation and Development of the Financial Market resulted in a boosted market dynamics. Only in 2020 the volume of trading in the investment funds' securities sector increased 22 times up to KZT20.3 billion, while the share of individuals accounted for 53.4% of the gross trading volume. The results of ten months of 2021 demonstrated a continuation of the trend – the trading volume for this period made up KZT33.9 billion which is 3 times higher than the result of the same period in 2020.

*“By virtue of changes in Kazakhstan’s legislation investing in UITs became easier on at least three positions. The first one is buying. When the case was with an over-the-counter fund, it was necessary to spend time, perform a series of actions, fill out paperwork. Now there is an exchange plus digital technology and you can buy a UIT unit in a couple of clicks. The second is an increased liquidity, that is, the sale of a UIT unit has become easier. Before, it was necessary to wait for the date of redemption for months, submit an application... The third simplification is taxation. The listing helped investors to optimize their tax to zero and retain savings. It is the listing of UITs on Kazakhstan Stock Exchange that made it possible to resolve these three things. Therefore, the activity of investors is increasing now”, thinks **Nurdaulet Aidossov**, Chairman of the Board of Jusan Invest Broker Company.¹⁵*

The increase in the share of the population in the stock market was also facilitated by the increased inclusiveness of brokerage services. By virtue of the specific legislation revision starting from October 2020 Kazakhstan's people were given the opportunity to open accounts using remote biometric identification. We should pay tribute to the efficient response of large broker organizations which almost immediately provided their clients with this service with the help of their mobile applications.

*"In response to infrastructure changes, we are also changing and as brokers we provide investors with new instruments. But, naturally, we do it with a certain lag. We need to reconfigure our IT systems, risk management systems... I think that biometrics will be, de facto, the standard in identifying our clients. Before the COVID-19 pandemic, there were very strong technological barriers to a client's first entry into the stock market infrastructure. There were high transaction costs, everyone suffered from this. Now the regulatory changes which affected the technological ones, are already giving a tremendous growth of clients, and this trend will only be growing", noted **Alexandr Dronin**, Deputy Chairman of the Board of BCC Invest JSC.¹⁶*

KASE also made its contribution to improving the convenience for retail investors to work with markets and presented the "KASE Mobile" application at the beginning of 2021. It supplemented the list of information products of the exchange and, first of all, was designed to simplify the access of retail and professional investors to the stock exchange information. The application allows you to participate in simulated trades on KASE and makes it possible to track market and reference information on the instruments most traded on the exchange. In addition, the first "Trading on KASE: from A to Z" comprehensive stock market educational program was launched in the fall of 2020 for novice investors, which apart from trainings and webinars, included contests for investors both within the framework of "simulated" trades and in the real market.

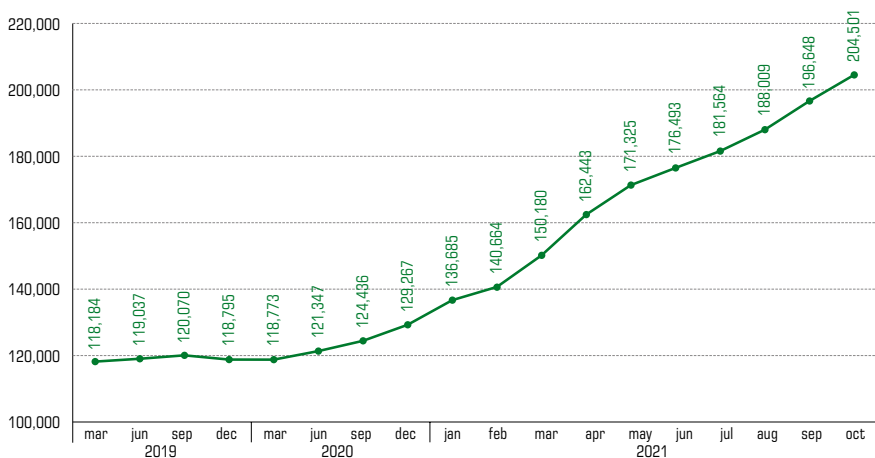
*"In general, it is clear that the KASE management has done a lot in recent years to develop the market. The exchange strives for best practices, and this already has its positive results: international investors operating in other markets come here realizing that the infrastructure is becoming similar to their usual one. Technology is important to the community of professionals and over the past 1.5 years, a significant breakthrough has been made on KASE. Standards, the right technologies, access system appeared in the market and companies began to engage in retail. We are heading in the right direction. For example, in 2020, more than 17 thousand accounts were opened in the Central Securities Depository, while more than 73 thousand new accounts have already been opened for 10 months of 2021", notes **Sergey Lukyanov**, Chairman of the Board of Freedom Finance JSC.¹⁷*

The digitalization of broker and exchange services, as well as general bullish determination mainly affected the performance of retail investors in the stock market. The volume of trades in the securities market in 2020 increased by 17.1% up to KZT238.4 billion, while the share of individuals in the secondary market accounted for 53.8% of the gross turnover of trades. The growth leaders at that time were the shares of KAZ Minerals and Kazatomprom. This trend continued in 2021: the volume of trading in shares for ten months made up KZT197.4 billion, which is 16% higher than in the same period of 2020.

In early 2021, regulatory changes allowed depositors of the Unified Accumulative Pension Fund (UAPF) to transfer the “excess savings” in their pension accounts to private management.¹⁸ Several broker organizations offered their potential clients the strategies for managing retirement assets. By October, four companies were managing retirement assets: Halyk Global Markets, Jusan Invest, BCC Invest and Centras Securities. KZT5.4 billion were under their management. The increase in the number of institutional investors not only created the basis for increasing the liquidity and efficiency of the stock market, but also created the preconditions for the development of a competitive environment in the asset management services market.

Together with the Agency for Regulation and Development of the Financial Mark KASE also continued to work on the projects for professional market participants and introduced the possibility of trading on omnibus accounts (eliminating the need for segregated accounting of each broker’s client), provided a number of innovations that made it possible to significantly reduce the costs of brokers in securing and fulfilling their obligations on stock exchange deals, introduced an electronic format for granting membership on the exchange, and also continued to expand the money market instruments. In particular, it increased the term of repo transactions to 90 days and proceeded to implementation of the project on introduction of clearing participation certificates (CPC), a fundamentally new financial instrument that will allow trading participants to more efficiently manage the collateral for stock exchange deals and “depersonalize” and unify the collateral as part of a security and as a subject of repo transactions.

THE NUMBER OF PERSONAL ACCOUNTS OF INDIVIDUALS IN THE CSD ACCOUNTING SYSTEM



In 2020 the Agency for Regulation and Development of the Financial Market with the participation of exchange structures, the Ministry of National Economy, the Ministry of Finance, the National Bank, the “Samruk-Kazyna” Fund and the EBRD also resumed a comprehensive work aimed at increasing the status of Kazakhstan’s stock market in the FTSE and MSCI classifications from Frontiers Market which was obtained in 2017, before “Emerging market” and “Secondary emerging market”, respectively.

Certain results have been achieved: according to the estimates of the units of MSCI and FTSE Russell international indices in 2021, the stock market of Kazakhstan already met the main quality criteria of MSCI “Emerging Market” and FTSE Russell “Secondary emerging market” in terms of regulation, legislation and infrastructure.

“Over the years, we have successfully adopted reforms to develop the securities market, provided new opportunities for the provision of brokerage services to the population by the banks, the opportunities of remote identification and many others. We are witnessing the blossom of mobile applications, synchronization of banks and brokers in customer servicing, the gradual recovery of market mechanisms of lending, as well as the increase in the liquidity of the local stock market. A significant event that increases the reliability and stability of the sector is the launch of the Central Counterparty in all major segments of the stock market and activity to bring the stock market in line with advanced international standards”, summed up the results of 2020–2021 Madina Abylkassymova, Chairman of the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market.¹⁹

SUSTAINABLE DEVELOPMENT IS NOT JUST WORDS

A new trend in KASE development strategy for 2019–2021 is the introduction of sustainable development principles. Its inclusion in the list of key priorities of the exchange not only corresponded to the general vector of the global exchange industry, but also made it possible to combine into a single system a range of targets aimed at increasing the investment value of KASE and increasing confidence in the exchange on the part of its partners and stakeholders. These included the improvement of the quality of risk management, internal control and audit, upgrading the transparency of KASE’s activities, introduction of environmental standards for doing business and strengthening of social responsibility.

“Methodological” evolution

Having joined the UN “Sustainable Stock Exchanges” initiative in 2015 KASE became one of the first who undertook a voluntary public obligation to promote environmental compatibility, social development and corporate governance criteria (ESG) among listed companies.

Since then KASE consistently promotes the best international practice in the field of sustainable development, including in terms of improving the disclosure of information on ESG among listed companies, conducting trainings and seminars, expanding the products that meet the principles of sustainable development. KASE is one of 57 UN Initiative partner exchanges promoting ESG criteria through training, and one of 101 distributing the methods of report preparation in accordance with ESG criteria.

The key ESG promotion tool, the Method of report preparation in accordance with ESG criteria, was developed by KASE at the end of 2016. It was aimed at assistance in the formation of appropriate corporate governance and risk management systems in companies that increase the attractiveness of issuers for foreign investors. In 2017, the exchange published the initial version of the method on its website and recommended the companies to use it in preparing relevant reports.

Starting from March 15, 2018 KASE launched an updated method²⁰ which takes into account the industry specifications across key economic sectors. The experts of the International Finance Corporation participated in the activity of its improvement and this assigned the international status to the method.

In February 2020 KASE updated the requirements for annual reports providing for additional disclosure of information on social responsibility and environmental compatibility for companies whose securities are in the “Main” category of the official list of the exchange.

The initiative of the exchange was of a great importance for the companies and made it possible to create a potential required in preparation of high-quality reports on sustainability issues. By the end of 2020, 76 out of 186 listed organizations provided annual reports with disclosure of ESG or its main elements.²¹

The next step to transfer the provisions of the method to the requirements for the preparation of annual reports was made in 2021. The exchange issued an independent document, “Information Disclosure Rules” which included the key requirements of the method. And if before KASE insisted on disclosing only the main points, now it requires full disclosure of information, including certain tabular specifications. The appendices that include a list of key performance indicators in relation to general, environmental and social issues have been issued. It also fully includes an assessment of key performance indicators in relation to corporate governance and such an important element as industry specifications guide.

The ESG pioneers

The growing interest in the ESG issue on the part of investors is also an opportunity to expand the product line with a focus on “green” and other bonds to finance the sustainable development projects.

In the first half of 2021 KASE created the infrastructure necessary for the issuance of ESG bonds on its trading floor and determined the requirements for such debt instruments, as well as benefits for listing fees.

The first issuers appeared: in November 2020 the Asian Development Bank issued the first green bonds and raised KZT14 billion (USD32 million), which were allocated for financing the bank’s projects related to adaptation to climate change and mitigation of its consequences in Kazakhstan.

In February 2021 the Asian Development Bank raised almost KZT8.4 billion (about USD20 million) on KASE within the frameworks of the first social bonds to provide affordable housing mortgage lending for female borrowers living in the regions.

In September 2021 social bonds of Damu Entrepreneurship Development Fund JSC were placed on KASE to finance small and medium-sized businesses from economic sectors most affected by the COVID-19 pandemic, as well as green bonds of the Eurasian Development Bank to finance ESG projects in the territory of Kazakhstan.

Successful promotion of ESG requires the involvement of different stakeholder groups. In July 2021 within the framework of the “Green Finance and the Debt Capital Market” conference, KASE together with the Agency for Regulation and Development of the Financial Market and PwC Kazakhstan signed a memorandum of cooperation in order to promote the sustainable financing principles. Under this Memorandum PwC Kazakhstan, as an independent consulting organization, undertook to provide methodological support and advice on the international practice of creating ESG projects financing infrastructure. In turn, the Agency for Regulation and Development of the Financial Market stated its intention to take measures to stimulate the transition of financial organizations and listed companies to ESG standards at a system level through their integration in the regulation of risk management and reporting systems. Subsequently, Expert RA and ACRA rating agencies, as well as the AIFC Green Finance Center expressed their readiness to confirm the targets of ESG for bonds placed on KASE.

Alina Aldambergen, the Chairperson of KASE’s Management Board is sure that strengthening of ESG-trends in Kazakhstan is only a matter of time: “At this point we don’t have investors specializing exclusively in securities of issuers who support the “green” economy. This is the matter to be resolved in the future. No doubt, “green” technologies are expensive today. But at the same time, special funding has already been provided for them and this makes their development possible. We have achieved a significant increase in the number of companies

*that meet the requirements of ESG standards for non-financial information disclosure. Building an infrastructure to issue sustainable bonds is underway at the moment. KASE itself has rather high standards of corporate governance, social responsibility and environmental compatibility*²²*

By personal example

The Exchange seeks not only to promote ESG principles among listed companies, but also tries to adhere to these principles in its activities. In October 2020 KASE adopted its own Sustainable Development Policy which determined the fundamental norms, principles, rules and approaches that must be followed when building a sustainable development management system. The policy was developed in accordance with the legislation of the Republic of Kazakhstan, KASE internal documents, the terms of the UN Global Compact and the UN Principles for Responsible Investment.

The Policy determines the following key conditions for KASE's transition to sustainable development: inclusion of sustainable development principles in the activities of the exchange; consolidation of the role, competence, responsibility of each unit and all employees for the implementation of sustainable development principles; introduction of the principles of transparency and measurability in achieving the sustainable development goal.

KASE corporate values symbolize the commitment to merge the business and the team of exchange in order to develop the stock market, improve existing and introduce new technologies, products and services, as well as achieve sustainable development by all market participants.

In 2019, the exchange staff elected those employees among their colleagues who demonstrate personal qualities that best meet the key postulates of the updated corporate values. Since then, the election of KASE value carriers has become an annual tradition.

Approaching the 30th round Anniversary of the Independence of the Republic of Kazakhstan, KASE confirms that despite the challenges associated with the global pandemic almost all the goals included in the exchange strategy for 2019-2021 have been achieved.

The projects implemented during these three years provided traders with new opportunities for effective activity on KASE markets. Modern trading systems, the ability to choose a wider range of financial instruments, types of submitted requests and trading modes, updated indicators as a reference point for the dynamics of markets and the value of assets over time, information and analytical products presented both in the information resources of KASE, and in leading agencies' terminals have become available to financial institutions and investors.

CORPORATE VALUES

The commitment of the exchange to sustainable business is also reflected in the updated corporate values developed and adopted by KASE in 2019.

Determination of corporate values meeting current challenges and self-identification of the exchange team became an important component of KASE operation as a team of professionals implementing strategically important projects for the development of the stock market. Following the internal discussion, the exchange team decided to adhere to such values as innovativeness, responsibility, openness and caring which were settled in the following statements:

- “We operate on the principles of innovativeness and sustainability for the general good, always adapting to changes”;
- “We are responsible for our decisions, proving our team’s professionalism and the high quality of services”;
- “We cooperate with our partners, clients and with each other on the principles of openness and transparency”;
- “We care for the future of our country, clients and employees, creating conditions for their development”.



KASE corporate values, 2019

The CCP service allowed investors to be confident in the timely receipt of assets under transactions, to adequately assess the risk profile of the market as a whole and use the available opportunities of a single limit in case of partial collateral for transactions made to increase liquidity.

KASE "digitized" the related services and strengthened feedback with issuers and investors.

All this, multiplied by the liberalization of legislation and global growth of interest in digital financial technologies laid a solid basis for a new impetus in the development of Kazakhstan's stock market.

The KASE team once again proved that it is able to look beyond the horizon, make plans and implement them in a professional way. And this competitive advantage guarantees that Kazakhstan Stock Exchange will remain in trend of the new time.



“Green Finance and the Debt Capital Market” Conference organized by KASE jointly with PricewaterhouseCoopers Kazakhstan and Halyk Savings Bank of Kazakhstan, 2021



Public lecture under “KASE Talks” project with the participation of Bolat Zhamishev, 2019

ABBREVIATIONS AND DEFINITIONS

| | | | |
|------------------------|---|--------------------|---|
| ACC | Association of Corporate Counsel | ETF | Exchange Traded Fund |
| ADR | American Depository Receipt, a type of a derivative | eTrade.kz | eTrade.kz LLP, the Exchange subsidiary |
| AFINEX | Almaty Financial Instruments Exchange CJSC (official abbreviated name of the exchange) | ETS | Eurasian Trading System Commodity Exchange |
| AFK | Association of Financiers of Kazakhstan | EUR | Common European Currency, Euro |
| AIFC | Astana International Financial Center | FCC | Freely convertible currency |
| AIX | Astana International Exchange | FEAS | Federation of Euro-Asian Stock Exchanges |
| ALT | Almaty time (GMT + 06:00) | FER | Floating exchange rate |
| APF | accumulative pension fund(s) | Fitch | Fitch, Inc.; |
| APF | Non-government accumulative pension fund | FIX | Financial Information Exchange, a data transmission protocol, which is an international standard for financial information exchange |
| ARA RFCA | Agency of the Republic of Kazakhstan on Regulation of Activities of the Regional Financial Center of Almaty | FRS | Federal Reserve System |
| ARDFM | Agency of the Republic of Kazakhstan for the Regulation and Development of Financial Market | FSA | Agency of the Republic of Kazakhstan on Regulation and Supervision of Financial Market and Financial Organizations |
| AST | Automated system of trading in financial instruments | FSC NBK | Committee for Control and Supervision of Financial Market and Financial Organizations of the National Bank of the Republic of Kazakhstan |
| Atameken NCE RK | Atameken National Chamber of Entrepreneurs of the Republic of Kazakhstan | FTSE | Financial Times Stock Exchange |
| AVMEKAM | Special currency government bonds of the Ministry of Finance of the Republic of Kazakhstan (from Kazakh) | FX reserves | Foreign exchange reserves |
| BCG | Boston Consulting Group | GDP | Gross domestic product (of the Republic of Kazakhstan, unless stated otherwise) |
| bn | Billion | GDR | Global Depository Receipt, a type of a derivative |
| BRM-2020 | Business Road Map 2020 | Government | Government of the Republic of Kazakhstan |
| Brokers/Dealers | Broker and/or dealer organizations | GS | Government issue-grade securities (of the Republic of Kazakhstan, unless stated otherwise) |
| CAPMEX | Consulting company founded in Vienna and providing services in the capital market, The Capital Market Experts | GTB | Government treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (generally applied to securities with any maturity period; a number after GTB means maturity period in months) |
| CASE CJSC | Central Asian Stock Exchange | IAE CIS | International Association of Exchanges of the Commonwealth of Independent States |
| CC | Central Counterpart, a person acting as an intermediate between the transaction parties and undertaking to perform such transaction | IAPF | Integrated Accumulative Pension Fund JSC |
| CIS | Commonwealth of Independent States | IBRD | International Bank for Reconstruction and Development |
| CJSC | Closed Joint-Stock Company | IC | Insurance company(ies) |
| CS | Corporate securities | IFC | International Finance Corporation |
| CSD | Central Security Depository JSC | IFO | International financial organization(s) |
| DEM | FRG mark | IMF | International Monetary Fund |
| DMA | Direct Market Access – direct access to the exchange trading system for the second-tier traders or exchange member clients | IOSCO | International Organization of Securities Commissions |
| EBRD | European Bank for Reconstruction and Development | IPO | Initial Public Offering |
| EMEA | Europe, the Middle East and Africa | | |

| | | | |
|---------------------|--|-----------------|---|
| IRBIS | IRBIS Information Agency of the Financial Markets LLP, KASE's subsidiary authorized to distribute exchange information | MCI | Monthly calculation index to calculate allowances and other social benefits and to charge penalties, taxes and other duties as required by the laws of the Republic of Kazakhstan; the value is provided by the Law of the Republic of Kazakhstan <i>On Republican Budget</i> for respective years |
| ISMA | International Securities Market Association | MCP | Money and Credit Policy |
| JSB | Joint-Stock Bank | MF | Ministry of Finance of the Republic of Kazakhstan |
| JSC | Joint-Stock Company | MICEX | Moscow Interbank Currency Exchange (Russia) |
| JSCB | Joint-Stock Commercial Bank | mln | Million |
| JV | Joint venture | MOEX | Moscow Exchange |
| KASE | Kazakhstan Stock Exchange | MRR | Minimum reserve requirements, a mandatory portion of the amount of bank's liabilities kept by the bank in a form of cash at hand in national and freely convertible currencies and cash on the correspondent accounts with the National Bank in national and freely convertible currencies (reserve assets) |
| KASE BTP | KASE basic trading platform (versus RFCA STP) | MUIKAM | Government long-term indexed treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of more than five years) (abbreviated title of securities in Kazakh) |
| KASE Index | KASE stock market index | MAOKAM | Government special medium-term treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with maturity periods of two and three years) (abbreviated title of securities in Kazakh) |
| KASE_BY | Corporate bond yield index | MAOKO | Government special compensatory treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with maturity periods of one, two and three years) (abbreviated title of securities in Kazakh) |
| KazPrime | Average value of deposit rates announced by the bank of the best credit quality for Kazakhstan | MEIKAM | Government indexed treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of three months and longer) (abbreviated title of securities in Kazakh) |
| KBTU | Kazakh-British Technical University | MEUZHKAM | Government long-term savings treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of more than five years) placed with accumulative pension funds (abbreviated title of securities in Kazakh) |
| KIBOR | Kazakhstan interbank offered rates | MEUKAM | Government long-term treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of more than five years) (abbreviated title of securities in Kazakh) |
| KIMEP | Kazakhstan Institute of Management, Economics and Forecasting | MEAKAM | Government special treasury bonds of the Ministry of Finance of the Republic of Kazakhstan with a maturity period of 10 years (abbreviated title of securities in Kazakh) |
| KISC | Kazakhstan Interbank Settlement Center of the National Bank of the Republic of Kazakhstan | | |
| KSE | Kazakhstan Stock Exchange before division into AFINEX and KASE | | |
| KTX | Kazakhstan Traded Index, KASE stock market index calculated by the Vienna Stock Exchange by weighing market capitalization, in EUR and USD. Stock prices at KASE are used for calculations | | |
| KZT | Kazakhstani tenge | | |
| LEA | Legal Entities Association | | |
| LEA | Local executive authorities | | |
| LIBOR | an interest rate for loans in different currencies granted by London banks, generally for 1, 2, 3, 6 or 12 months | | |
| LLP | Limited Liability Partnership | | |
| LME | Generally accepted name of the London Metal Exchange | | |
| LSE | Generally accepted name of the London Stock Exchange | | |
| Market maker | Exchange member recognized as such by the exchange, who undertook to declare and maintain bilateral quotations for securities of a certain type | | |

| | | | |
|-------------------------|---|----------------------------|---|
| MEKAVM | Government short-term treasury currency bonds with a maturity period of three, six, nine and twelve months (abbreviated title of securities in Kazakh) | People's IPO | Program for the Placement of Stock of Subsidiaries and Affiliates of Samruk-Kazyna National Welfare Fund Joint-Stock Company on the Securities Market approved by Resolution of the Republic of Kazakhstan No. 1027 dated September 8, 2011 |
| MEKAM | Government treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (generally applied to securities with any maturity period) (abbreviated title of securities in Kazakh) | PI | Price index |
| MEKKAM | Government short-term treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of one year and less) (abbreviated title of securities in Kazakh) | QTS | Quotation trading system of KASE |
| MEOKAM | Government medium-term treasury bonds of the Ministry of Finance of the Republic of Kazakhstan (with a maturity period of more than one year to five years) (abbreviated title of securities in Kazakh) | RF | Russian Federation |
| MOIKAM | Government medium-term indexed treasury bonds of the Republic of Kazakhstan with a maturity period of more than one year to five years (abbreviated title of securities in Kazakh) | RFCA | Regional Financial Center of Almaty |
| NBRK | National Bank of the Republic of Kazakhstan | RFCA STP | Special trading platform of the regional financial center of Almaty |
| NGS | Non-government issue-grade securities | Risk Mitigation Law | Law of the Republic of Kazakhstan <i>On Amendments to Certain Legislative Acts of the Republic of Kazakhstan on Regulating Banking Activities and Financial Organizations in Risk Mitigation</i> No. 524-IV dated December 28, 2011 |
| NIN | National Identification Number of securities assigned as provided for by the laws of the Republic of Kazakhstan | RK | Republic of Kazakhstan |
| NSB | National savings bonds of the Ministry of Finance of the Republic of Kazakhstan | RLA | Regulatory legal act |
| NSC | National Securities Commission of the Republic of Kazakhstan | RMS | Risk Management Service |
| NWF | National Welfare Fund | RUB | Russian ruble |
| NYMEX | New York Mercantile Exchange (NYC, USA) | S&P | Standard & Poor's |
| NZ | SOS series admitted for sale in Non-Listed Securities sector at KASE | SAPF | SAPF Accumulative Pension Fund JSC ((CJSC) until 2003) |
| OECD | Organization for Economic Cooperation and Development, international economic organization | SB | Subsidiary bank |
| OJSC | Open Joint-Stock Company | SEZ | Special Economic Zone |
| Operating margin | Ratio of operating profit (operating profit before taxes and interest) to sales volume | SM BDA | Securities Market Broker/Dealer Association of the Republic of Kazakhstan |
| ORR | Official repo rate | SME | Small and medium-sized enterprises |
| PA | Pension assets | SOS | State-owned stocks |
| PAIMO | Pension asset investment management organization(s) | SPO | Secondary public offering |
| PAMC | Pension asset management company | Spot | Condition of settlements, where the transaction is performed on the second business day from the transaction date |
| | | SPT | Condition of settlements, where the transaction is performed on the second business day from the transaction date (from "spot") |
| | | SPV | Special Purpose Vehicle (a special enterprise, a legal entity, which is a non-resident of the Republic of Kazakhstan, issuer of the international bonds, whose sole founder (member, shareholder) is a legal entity of the Republic of Kazakhstan, acting as a guarantor of performance for such bonds) |
| | | SRO | Self-regulated organization |
| | | SSE | Sustainable Stock Exchanges Initiative |
| | | STB | Second-tier bank(s) |

| | | | |
|--------------|---|---------------------------|---|
| sukuk | an instrument commonly used in Sharia countries, so-called Islamic equivalent of bonds | Trading system, TS | Trading system of Kazakhstan Stock Exchange JSC |
| SWIFT | Society for Worldwide Interbank Financial Telecommunications | TRION | Weighted average interest rate on repo transactions for one day with the GS Basket carried out with the participation of the Central Counterparty calculated during each trading day. |
| T+0 | see TOD | trn | trillion |
| T+2 | see SPT | TTS | Training trading system of the Exchange |
| T+3 | Condition of settlements, where the transaction is performed on the third business day from the transaction date | TWINA | An interest-rate average calculated for the repo opening transactions for seven days in the market of auto repo with government securities of the Republic of Kazakhstan |
| T+1 | see TOM | URR | Unified repo transaction rate |
| T+n | Condition of settlements, where the transaction is performed on the n-th business day from the transaction date | USA | United States of America |
| TCS | Trading and clearing systems of "Kazakhstan Stock Exchange" JSC | USAID | United States Agency for International Development |
| TOD | Condition of settlements, where the transaction is performed on the same day (from "today") | USD, \$ | US dollar |
| TOM | Condition of settlements, where the transaction is performed on the next business day after the transaction date (from "tomorrow") | WBAG | Wiener Borse AG, Vienna Stock Exchange |
| TONIA | An interest-rate average calculated for the repo opening transactions for one day in the market of auto repo with government securities of the Republic of Kazakhstan | WFE | World Federation of Exchanges |
| | | Z | SOS series admitted for sale in SOS trading sector at KASE |

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**The editorial board would like to thank all those people,
who assisted in collecting information and writing this book
by sharing their memories:**

| | |
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CONTENTS

| | | |
|------------|---|------------|
| Chapter 1. | IN THE BEGINNING WAS THE TENGE | 6 |
| | NEW EXCHANGE FOR THE NEW CURRENCY..... | 7 |
| | THE PRICE OF INTER-OFFSET..... | 10 |
| | THE FIRST STABILITY..... | 14 |
| | FLOATING EXCHANGE RATE AS A RESPONSE TO CRISIS..... | 23 |
| Chapter 2. | WHERE THE MARKET IS BORN | 34 |
| | FALSE START OF THE GTB MARKET AND THE STRUGGLE FOR THE STATUS OF A MODEL EXCHANGE..... | 36 |
| | UNDER THE FLAG OF BLUE CHIPS | 39 |
| | GS RETURN AND LAUNCH OF THE DOMESTIC EURONOTE MARKET | 43 |
| | FLOATING EXCHANGE RATE AND SECURITIES MARKET | 49 |
| | ON THE EVE OF A BOND BOOM | 52 |
| Chapter 3. | PATTERN OF GROWTH | 60 |
| | GS MARKET: TIME AND BURDEN OF "OVERHEATING" | 61 |
| | THE CORPORATE BOND MARKET: ON THE WAVE OF THE "BOND BOOM" .. | 72 |
| | STATE-OWNED STAKE TRADE SECTOR: NOT ONLY FOR "STRATEGISTS" | 78 |
| | STOCK MARKET: FROM SKEPTICISM TO EUPHORIA | 82 |
| | REPO TRANSACTION MARKET: MOVES AND WINS | 90 |
| | FOREIGN EXCHANGE MARKET: THE MOMENT OF GLORY FOR TENGE..... | 99 |
| | KASE AND THE REGIONAL FINANCIAL CENTER (RFCA) PROJECT | 104 |
| Chapter 4. | A CRISIS CHALLENGE | 112 |
| | FORERUNNERS OF THE FIRST WAVE | 112 |
| | ALL-OUT ATTACK | 120 |
| | THROUGH DEVALUATION AND DEFAULTS TO RECOVERY AND GROWTH | 128 |

| | | |
|------------|---|------------|
| Chapter 5. | LEARNING LESSONS | 138 |
| | THE FOUNDATION FOR A NEW LEAP..... | 139 |
| | TRYING TO MAKE A START UP..... | 146 |
| | TASKED WITH RISK MITIGATION..... | 157 |
| Chapter 6. | TIME OF CHALLENGES AND TRANSFORMATIONS | 172 |
| | ON THE WAY TOWARD A NEW MONETARY POLICY | 172 |
| | PENSION SYSTEM REFORM: ONE INSTEAD OF MANY | 180 |
| | PEOPLE’S IPO: LIFE AFTER START..... | 186 |
| | FOUR IMPORTANT STEPS TO BOOST LIQUIDITY | 190 |
| | CHANGING LEGISLATION..... | 194 |
| | IN PURSUANCE OF INTERNATIONAL STANDARDS | 196 |
| Chapter 7. | FUTURE IS CREATED TODAY | 200 |
| | ON INFLATION TARGETING TREND..... | 200 |
| | IT’S TIME FOR THE SECURITIES MARKET..... | 209 |
| | GROWTH STRATEGY | 211 |
| Chapter 8. | THE MODERNIZATION STAGE | 222 |
| | PANDEMIC – A NEW REALITY | 224 |
| | THE BENEFITS OF STRATEGIC PARTNERSHIP | 231 |
| | THE SYNERGY OF REFORMS | 239 |
| | SUSTAINABLE DEVELOPMENT IS NOT JUST WORDS | 247 |
| | ABBREVIATIONS AND DEFINITIONS | 254 |
| | REFERENCES AND NOTES | 258 |

Kazakhstan Stock Exchange

Building the future / – Almaty, 2021 – 270 p., English

The second revised edition of the “Building the future” book dedicated to the history of the Kazakhstan Stock Exchange development issued to the 30th Anniversary of the Independence of Kazakhstan. The first edition of 2018 was timed to coincide with the 25th anniversary of KASE. KASE established as Kazakh Interbank Currency Exchange on November 17, 1993 became a universal trading platform for the markets of money, securities, foreign currencies and derivatives, passed several stages of modernization and continues to develop dynamically, considerably contributing the economy of Kazakhstan.

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Printed from the customer's files by Indigo Print LLP;
office 200, 2/2, Kabanbai batyr Avenue, Nur-Sultan, Kazakhstan





30

YEARS OF INDEPENDENCE
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