

Kazakhstan Stock Exchange: Global Challenges, Local Strategies

Photograph by Yaroslav Radlovskiy



Today, stock exchanges globally are steering through turbulent times with a number of factors influencing their development in one direction or another. It was not long ago, when exchanges faced numerous problems such as falling indexes, lower trading volumes, lack of investors' confidence, postponed companies' IPOs due to worsened market conditions. On the positive side, the crisis gave impetus to new opportunities. Now stock exchanges are rethinking their strategies, working to become more efficient and fiercely competing for each and every client.

*World Finance Review spoke with **Andrey Tsalyuk**, Vice-President of the Kazakhstan Stock Exchange (KASE) to find out what new developments are on the way at the Central Asia's leading exchange.*

Has the financial crisis given impetus to creating new and more efficient stock exchange mechanisms in Kazakhstan?

Of course. It would not be an overstatement to say that over the past three years the exchange has built its operations mainly on the basis of the experience drawn from the lessons of the crisis and the recession that followed.

To remind, the KASE is a universal exchange. It is a place, where foreign currencies, government and corporate securities, as well as derivative instruments are traded. Repo transactions and currency swap deals are also done at the KASE. We had to "fine-tune" each of these sectors to ensure their efficient operation during and after the crisis.

At its FOREX section, the KASE has set up a Committee for the Foreign Currencies Market – a permanent external body, whose main task is to detect insolvency of the market participants. When needed, the Committee may decide to switch to the mode when members have to pay and deliver on the deal before the transaction takes place.

As a measure to improve the nego repo transactions market negatively affected by the devaluation of shares and bonds, we have introduced the mark-to-market system.

In response to defaults of some KASE-listed companies, jointly with the regulator, the exchange has developed a so-called buffer category of the official list, to which bonds of issuers failing to comply with the listing requirements are transferred. This step enabled some companies to avoid delisting and to implement measures to restore compliance with the listing requirements. In an attempt to curb the significant number of failed transactions in the stock

market, the KASE is currently introducing a settlement scheme based on T+0 with full pre-depositing of securities and cash funds at the moment of submitting a purchase or sale order.

We have launched a new derivatives market that is different from the previous one by much better risk management. Now, the KASE acts more as a counterpart and warrants settlements of deals staying within the amount of the guarantee and reserve funds.

The past two years were devoted to the creation of effective internal audit and risk management units at the exchange. Other measures are also planned.

Access to international funding: what are the current realities in terms of access to capital for Kazakh companies?

Kazakhstan regularly avails itself of borrowing on the global capital markets; this particularly applies to banks. Before the crisis, we overtook other CIS countries in this respect, and this became the reason for the stronger impact of the crisis on Kazakhstan.

Today, we can say that international capital markets re-opened their doors to Kazakh companies; at least, for the most reliable of them the year 2010 was a breakthrough year. Extremely cheap money made our issuers more active: throughout 2010, bonds of Kazakhstan TemirZholy, Kazatomprom, KazMunaiGas and the Development Bank of Kazakhstan were offered abroad. This year, Halyk Savings Bank of Kazakhstan raised USD500 million via Eurobonds; Kazkommertsbank is currently finishing its own fundraising. Most of the mentioned bonds underwent listing at the national stock exchange, as well. All that led to the capitalisation of KASE-traded

bonds soaring to a historical high of USD40 bn in equivalent; a year ago this figure was only half as much. In terms of equity finance, local companies have not had a go yet; as far as I know, there have not been any attempts to do IPOs abroad.

Can the local stock exchange be a source of capital for Kazakh companies? Why would Kazakh companies choose KASE over, say, Hong Kong or Russia for an IPO?

Unfortunately, as yet, with few exceptions, local companies have not considered the home market as the main source of funding. With debt financing fairly well developed, equity finance is not very popular over here. Major companies deem the home market too small, medium-sized and small businesses are not happy with the disclosure requirements, since it implies transparency – something not everyone likes.

We are convinced, however, that the current situation could be and should be changed. In fact, our market underwent a serious test during the IPO of KazMunaiGas Explorator Production in 2006, whereas the said corporation did IPO simultaneously at the LSE and in Kazakhstan. Just over USD2 bn were raised at that time, 64% of them - in Kazakhstan.

Since last year, the KASE, in association with the management of the Regional Financial Centre of Almaty, pushes through with an idea that all IPOs of Kazakh companies should predominantly take place at home, because local pension funds suffer from lack of attractive financial instruments, with the population taking virtually no part in the stock market. And foreign investors should come over here to buy stocks offered by local businesses. Only this way can we develop our market.

It is now obvious that this scenario enjoys support from the regulators and the government. The Road Map – a package of measures, which envisages a move in this particular direction – has been adopted. Plans to introduce tax incentives and even administrative bans on foreign IPOs are being considered as a measure to cover domestic demand.

In other words, it is a matter of creating incentives to change the preferences of Kazakh companies towards the KASE as a floor for IPOs over Hong Kong or Russian stock exchanges.

How attractive is the Kazakh stock exchange for investors and what can be done to stimulate higher interest?

This is a fair question, I quite agree. We are not sitting back doing nothing, but we are putting efforts to making our exchange attractive in the eyes of foreign investors.

As I said above, over the past three years we have made our stock market more reliable. I dare say that this reliability is even not liked by some, as it brings the former laxness under control. However, foreigners will like this type of reliability.

We are thoroughly examining the issue of direct membership for non-residents on the KASE. Quite a lot has already been done in this direction: 2010 brought us the first member of foreign origin – the Russian Promsvyazbank that is now a full-fledged party in our foreign exchange market. The stock market membership is being comprehensively examined from the legal perspective. As a matter of fact, our regulatory framework does not contain any prohibitions.

We have also been busy with the technical aspects of direct access to our market (DMA). On one hand, the KASE has developed and is currently launching its Internet trading platform. On the other hand, works are underway, which will enable well-known Internet-trading providers to connect their trading platforms to our trading system as early as this year. During 2010 we met up with envoys of virtually all major stock exchanges, who presented their trading and post-trading systems as an alternative to our own trading infrastructure. We understand that using a recognised brand will increase the KASE's attractiveness in the eyes of foreign investors. We have also considered offers from many firms designing trading systems and post-trading service. We disseminate data worldwide through major data vendors and have made significant progress on issues related to the reliable delivery of such data.

Settlements are the top priority for us. Currently, deals concluded on the KASE securities market are settled the same day (+0 scheme) in the so-called "deal after deal" mode. By the end of this year we plan to launch the +3 settlement scheme with multilateral CCP clearing. This means that default risks will be borne by the Guarantee Fund formed by trading participants, and the Reserve Fund set up by the KASE. The risk of price change throughout the settlement cycle will be margined. However, I need to point out that this scheme does not make local market participants happy as most of them prefer quick settlements.

Let us get down to the nitty-gritty. A major drawback of the stock market in Kazakhstan is its narrowness and lack of shares from promising businesses. Only IPOs can offer a way of tackling this issue. We may ramble on many things, however unless we saturate the market with goods, we shall have no market as such, whatever technologies are used and whichever investors are attracted.

Perspectives of the national IPO in Kazakhstan: what are the expected results?

KASE will admit major national companies with no prior records of going public on organised markets. That will improve both their transparency and operational effectiveness.

The home market will receive new equity instruments so badly needed, and its capitalisation will increase significantly as a result.

Several thousand retail investors may be attracted to the stock market giving momentum to shares' liquidity as well as facilitating the derivatives market's development.

The inflow of foreign investors to the domestic market will increase as they will be interested in buying shares, which are not sold anywhere else (if they are not allowed to take part in IPOs, they will buy shares on the secondary market). KASE expects other results talking about which would go beyond this interview.

Does the current technological infrastructure fulfil the growing needs of the market participants? Are there any new financial instruments planned to be introduced this year?

Yes, I think that the existing infrastructure caters for the needs and would even be sufficient for a more liquid market. Despite some worries related to risks, we

are busy looking for solutions. I think, such troubles are commonplace.

It is important to come up with ideas on new instruments – stocks of large national and quasi-government companies. This is what the market needs right now. In addition, we are opening trading in new currency pairs (e.g., yuan/tenge). Futures contracts on most liquid stocks, as well as Islamic instruments, are the promising opportunities, too.

Cooperation with other exchanges: what kind of experience can be beneficial for the KASE to improve its efficiency?

In 2010, thanks to our active cooperation with the largest trading platform operators and our membership in the Exchanges Association, we learned a lot of new things. I think, the most useful of them were the market making experience, organisation of post trading procedures (settlements, clearing), exchange risk management, dissemination and selling of market data. Some listing aspects were also interesting.

A well defined vector in the KASE's development facilitates our aspiration for full membership in the World Federation of Exchanges (WFE); at present we are an affiliated member there. In fact, we build our strategy on the objective of achieving compliance with the criteria for membership in this institution. To achieve this, we need to thoroughly study the international experience.

KASE goes to great lengths to implement modern technologies. If at the moment we cannot afford any of the well-known trading systems, we modernise our own system. Right now we are composing an engineering team, whose task is to significantly improve the efficiency of the KASE trading system through using the latest novelties in the software development industry to upgrade the system's nucleus. As I have already said, over the past two years we have made a good progress in terms of Internet-trading technologies and dissemination of real-time market data.

Since Kazakhstan is the pace-setter in the market economy across the post-soviet Central Asia, demand for our experience is on the rise. Currently, Kyrgyz Stock Exchange uses KASE trading system and we are keen to promote this product further.

Thank you for the interview.