

# **NATIONAL BANK OF KAZAKHSTAN**

## **ANNUAL REPORT**

**2001**

**Almaty, 2002**

The report of the National Bank of Kazakhstan for 2001 is prepared according to the clauses 66 and 67 of the Law of the Republic of Kazakhstan "On the National Bank of the Republic of Kazakhstan" №2155 dated March 30, 1999.

Annual balance sheet and income statement of the National Bank of Kazakhstan for 2001 are confirmed by auditor report of "Arthur Andersen" CJSC.

The report of the National Bank of Kazakhstan for 2001 was approved by the Edict of the President of the Republic of Kazakhstan №851 on April 22, 2002.

Pursuant the Edict of the President of the Republic of Kazakhstan №852 on April 22, 2002, the net income earned by the National Bank of Kazakhstan in 2001 fiscal year was distributed as follows:

Authorized capital – 4,53 bln. Tenge.

Reserve capital– 4,15 bln. Tenge.

Republican budget revenues– 10,51 bln. Tenge.

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## INTRODUCTION

In 2001 Kazakhstan saw the highest rate of economic growth since its independence. Real GDP rose 13.2% and was provided by an increased growth in major sectors of economy. The industry output increased by 13.5% showing the highest growth in the country's history.

2001 was a relatively favorable year in terms of external economic developments despite gradually falling oil and metal prices and a slowdown of the world economy growth, which was 2.4%.

An economic improvement in most CIS countries had affected positively the development of Kazakh economy in 2001 (Table 1). The relative political, macroeconomic and financial stability achieved in Russia, a major trade partner of Kazakhstan, fueled a rise of economic activity in a region.

*Table 1.*

**Changes in Main Macroeconomic Indicators of CIS and Baltic Countries in 2001, %**

Countries	Real GDP	Inflation (December over December)	Change of National Currency against USD*
Kazakhstan	13,2	6,4	3,8
Russia	5,7	18,6	5,6
Ukraine	9,0	6,1	-2,4*
Belarus	4,1	46,1	33,9
Moldova	6,1	6,3	5,8
Uzbekistan	4,5	26,2	112,3*
Kyrgyzstan	5,3	3,7	-1,2
Azerbaijan	9,9	1,3	4,6
Georgia	4,5	3,4	4,8*
Armenia	9,6	2,9	1,8*
Tajikistan	10,2	12,5	н/д
Latvia	6,0	2,3	2,8
Lithuania	3,6	0,6	0,0
Estonia	4,5	5,7	2,8

\*- official exchange rate

Monetary policy pursued by the National Bank of the Republic of Kazakhstan has promoted macroeconomic stability considerably. Inflation rate was reduced and reached 6.4% by the end of the year. Gradual money supply of the economy was ensured, and the economy's monetization level went up to 17.3%. Over appreciation of Tenge was not allowed. This enabled to retain price competitiveness of Kazakh commodities in the external markets, and thus facilitating a revival in import-substitution as well as export-oriented sectors.

Re-financing rate saw several reductions during the year down to 9% - the lowest level among CIS countries. Accordingly, the official rate policy encouraged the second-tier banks to reduce their lending interest rates making credit resources more accessible.

To reduce budget vulnerability to the world price fluctuations and to accumulate financial assets for the benefit of future generations, the National Fund of the Republic of Kazakhstan, which collects part of tax revenues raised from the enterprises operating natural resources, launched its full scope functioning. In order to enhance the efficiency of state investment the Development Bank of Kazakhstan was established.

An upgrade of sovereign ratings on the long-term loans in foreign currency from "BB" to "BB"/"Ba2" by three International Rating Agencies Standard&Poor's, Moody's Investors Service и Fitch proved recognition of economic improvement in Kazakhstan in 2001.

## **I. ECONOMIC DEVELOPMENT**

### **1.1. Real Sector of Economy<sup>1</sup>**

In 2001 the authorities were able to retain positive dynamics of major economic indicators as well as substantially strengthen the progress achieved in economic growth during three last years. Strengthened economic growth was provided by an increased rise of outputs in industry, construction, agriculture, transport and communications.

The volume of industrial output increased by 13,5%, including 17% rise in mining, 14,8% - in processing, and 3,3% - in production and distribution of electricity, gas and water. Structural change of industrial production was an important sign of economy's positive restructuring. A share of processing industries in total industry output exceeded that of mining and was at 47%.

Moreover, in 2001 the highest growth was recorded in agriculture, where the volume of gross output went up by 16,9%.

Investment activity of the domestic and foreign capital as well as the efficient investment policy of the government have considerably contributed to the economic growth of the country. Investment in fixed assets rose by 21% in 2001.

Given that considerable positive changes in the structure of economy's sectors evolved in 2001, the volume of capital construction investment in processing industries rose significantly (by 88,1%). Meanwhile, capital construction investment in mining went by 30,5% only, however, its share in total capital construction investment remains still high – 58,4%.

As a result of the improved economic conditions, capital investment in health and social services increased substantially – 2,9 times, that in construction – 2,8 times, and government management and education – 2,6 times.

In 2001 the enterprises and organizations continued to finance capital construction from their own capital – a share of own sources in total financing was 58,4%.

Given the industrial growth, the volume of transportation increased. The volume of delivered services in this sector rose by 11,3% in 2001, and that delivered by the communication enterprises exceeded the previous year level by 38,5%.

Favorable economic situation, including industry growth invoked positive changes in price structure. The producer prices in industry declined by 14,1% in 2001, and intermediate consumption products and consumer goods became cheaper by 18,2% and 0,4%, respectively. However production means became more expensive by 2,7%, reflecting an increased demand due to the growth of production capacity.

Nevertheless, in 2001 the consumer prices grew up, although insignificantly: food, non-food prices and tariffs on paid services for the population rose 8,8%, 4,5%, and 3,6%, respectively. In a whole, an annual inflation rate (December over December) went down from 9,8% to 6,4% (Annex 1).

### **1.2. Fiscal Policies<sup>2</sup>**

Positive tendencies in the economic development of Kazakhstan had a favorable effect on budget execution as well as dynamics of domestic government debt. The state budget revenues exceeded the planned targets, and budget programs were financed practically in a full scope.

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<sup>1</sup> Based on the data of the Statistical Agency of the Republic of Kazakhstan

<sup>2</sup> Based on the data of the Ministry of Finance of the Republic of Kazakhstan. The data on state budget execution and domestic debt exclude counting period.

In 2001 the fiscal measures, which have significant importance for the country's economy development, were carried out. For the first time, the budget was worked out based on the medium-term targets. Since July 1, the rate of value-added tax was reduced from 20% to 16% and that on social tax was brought down to 21% from 26%, enabling to ease a tax burden on the enterprises considerably. Levying indirect taxes based on a "destination basis" in trading with CIS countries was put into effect. One of successes achieved in government debt management was an increasing maturity of government securities and continuing reduction of their yields.

Based on the outcome of 2001, the state budget revenues were 743,5 bln. Tenge or 22,6% of GDP. Tax rate reduction did not affect budget revenues: annual budget plan on VAT collection was over-executed by 11,6%, and that on social tax - by 8,0%.

Expenditures and lending were made in the amount of 749,1 bln. Tenge. The state budget deficit was 5,5 bln. Tenge or 0,2% of GDP.

In 2001 the revenues of the Republican budget were 487,6 bln. Tenge worth. As compared with 2000, a rise of budget revenues was 27,7%. Taxes ensured major revenues of the Republican budget, and VAT and Income Tax dominated in structure of tax revenues. Payments for the use of natural resources, excise taxes and customs payments ensured considerable receipts as well.

Expenditures and lending of the Republican budget were financed in the amount of 492,0 bln. Tenge. Spending on agriculture and water maintenance, transport, communications and education increased substantially. For the first time, the expenditures on defense reached 1% of GDP pursuant Military Doctrine.

The reduced need in borrowing enabled the Ministry of Finance of Kazakhstan to decrease the amounts and yields of government securities placed. As a result, spending on government debt servicing was executed in 2001 at 96,5% of the planned level.

Based on the outcome of 2001, the Republican budget had deficit of 4,3 bln. Tenge. Its external financing amounted to 4,8 bln. Tenge, since financing from the domestic sources was negative – (-)0,5 bln. Tenge.

Despite favorable budget revenues, spending remained uneven during the year. Most outlays on budget programs were made in the second half of the year and caused a sharp reduction of Government deposits in the National Bank of Kazakhstan by the end of the year. These changes in deposits invoked considerable and undesirable fluctuations of the monetary base and forced the National Bank of Kazakhstan to incur significant costs on monetary activity in order sterilize it.

As of end of 2001, the domestic government debt was 84,0 bln. Tenge worth, having been reduced by 3,9% over the year. In the course of the year a share of medium and long term bonds denominated in the national currency surged up considerably (from 52,2% to 81,6%), and a share of short-term securities declined from 17,6% down to 2,5%.

Thus, the Ministry of Finance of Kazakhstan faced no problems with current liquidity and the government securities were issued to re-finance more lengthy government debt and develop further this segment of financial market. A shrunk share of liabilities denominated in US dollars (from 30,2% to 15,9%) in domestic debt structure was also positive development. Given this, all government bonds in the domestic market are denominated in national currency.

### **1.3. Balance of Payments and External Debt (Annex 2)**

Continuing high-rate growth of the Kazakh economy along with simultaneous strengthening of negative trends in the developed economies pre-determined the balance of payments developments in 2001.

The world prices on mineral resources were declining in the course of whole 2001 due to a reduction of external demand, which dropped sharply after the events on September 11 in the USA. Since early 2001 an average weighted index of the world prices for main Kazakh exports declined by 23,4% (fourth quarter of the reporting year to the fourth quarter of 2000), including decline by 13,4% in October-December 2001 only. The average weighted index of Terms of Trade<sup>3</sup> in 2001 was 6,8% below that in 2000.

Price factor made a considerable contribution to a slowdown of export growth rate accumulated in 2000. While the physical volumes of the exported ferrous and non-ferrous metals remained practically the same, their values fell significantly. An increase of the exported oil and gas quantities during the first quarters of 2001 compensated price factor impact and ensured maintaining export revenues at the level of 2000 (physical volumes of oil and condensed gas exports grew up by 24,5% against the respective 9 months of 2000), but a sharp fall of prices at the end of 2001 led to diminished export revenues. In total, exports value in 2001 was USD9,1 bln. worth and went down by 2% against 2000 given the preserved revenues from oil and gas exports (USD4,3 bln.) at the level of previous year, eventually strengthening a tendency of export concentration on mineral resources.

Increased volumes of extracted oil and gas, employment of new oil/gas-deposit fields, development of the existing production capacities as well as operation of new capacities in mining sector provided growth of capital investment. An increased investment activity and a rise of real income of population were accompanied by a considerable increment of imports and, as a consequence, contraction of net exports. The value of commodities imported to Kazakhstan in 2001 was estimated at USD8,2 bln., that is, 20% above the imports in 2000. The growth of imported intermediate and investment commodities made a major contribution to a sharp upsurge of imports value. In 2001, these commodities were imported in the amount of USD3,2 bln., exceeding the respective imports in 2000 by one third (Figure 1.3.2). Trade balance surplus in 2001 was about USD0,9 bln., having squeezed 2,7 times as compared with a similar indicator of 2000 (USD2,4 bln.).

Implementation of large scope investment projects by the oil-gas enterprises resulted in a rise of imported international services, as well. During 2001 the value of imported construction and other business services including geological exploration and consultancy, was over USD1,5 bln., showing an increase by more than 46% over that in 2000. Given that exports of services rose almost 13%, this fueled an expansion of negative balance of international services up to USD1,6 bln. Since the net payments for the use of foreign capital (about USD1,2 bln.) remained almost unchanged as compared with those in 2000, the current account came out considerably negative. The current account deficit of the Kazakhstani balance of payments in 2001 was USD1,7 bln. worth, or 7,8% of GDP.

Table 1.3.2 gives dynamics of current account main indicators of the balance of payments for the last five years.

Table 1.3.2

**Current Account Main Indicators of the Balance of Payments of Kazakhstan**

	1997	1998	1999	2000	2001
<i>in USD mln.</i>					
Trade balance	-276	-801	340	2440	896
Exports	6899	5871	5989	9288	9120
Imports	-7176	-6672	-5648	-6848	-8224
Services, income & transfers, net	-523	-435	-576	-2028	-2644
Current account	-799	-1236	-236	412	-1748
<i>in % of GDP</i>	-3,6	-5,6	-1,4	2,3	-7,8
<i>Change over previous period, in %</i>					

<sup>3</sup> Index of Terms of Trade is calculated as a ratio of change of external prices on exports to that of imports. Index growth means improvement of external competitiveness of the country's economy and index decline implies worsening of the competitive position of the country in the world economy.

Exports of Commodities	9,7	-14,9	2,0	55,1	-1,8
Imports of Commodities	8,3	-7,0	-15,3	21,2	20,0
Terms of Trade	1,7	-18,0	15,2	26,6	-6,8
Real Effective Exchange Rate, December over December, in % <sup>4</sup>	8,9	16,2	-26,4	2,8	-1,6

The current account needs were more than fully financed by an inflow of foreign direct investment. Gross inflow of foreign direct investment into Kazakhstan in 2001 achieved the record level amounting to over USD4,4 bln., of which 74% falls on mining of oil and natural gas, 10% – on geological exploration, and 3% – on transportation by pipelines. Given an insignificant reduction of the re-invested profits (USD0,4 bln.), the inflow was provided by raising of new financing.

The foreign direct investment in share capital of Kazakh enterprises (USD530 mln.) was provided by the receipts under the contracts made in 2000 on sale of 5% state stake in the joint venture “TengizChevroil” to the American corporation “Chevron” and sale of 30% state stake in Open Joint Stock Company “Mangistaumunaigas” to the Indonesian company “Central Asia Petroleum Company”.

An implementation of large scope investment projects in exploration, employment and development of infrastructure at Tengiz, Eastern Kashagan, Karachaganak, Kumkol oil-fields and construction of Caspian pipeline, ensured that transnational companies enhanced considerably financing of their subsidiaries in Kazakhstan. In 2001 the inflows into non-share capital of the enterprises, except re-invested profits, was USD3,4 bln. worth, having exceeded that in 2000 almost 1,7 times (over USD2 bln.).

The working capital and capital investment are largely financed in the form of credits and loans provided by the direct investors. An active upsurge of outputs, stimulated by the direct investors, enabled the direct investment enterprises to pay off their debts intensively from their increased profits. In 2001, the debt repaid to the parent companies including capitalization of the accrued interest was USD1,8 bln. worth, having exceeded that of 2000 by 26%. The mining enterprises provide three quarters of this capital outflow. Accounting for debt repayment by both Kazakh enterprises and foreign parent companies, the net inflow of foreign direct investment into Kazakhstan was USD2,7 bln. worth, having more than doubled as compared with 2000.

The structure of direct investment by sourcing countries was determined by a stake of foreign companies in the joint ventures in oil and gas sector: 33% of gross inflow of foreign direct investment into Kazakhstan came from the USA, 17% - from Canada, 14% - from UK, 11% – Italy, and 5% - from China and Russian Federation each. Investment in foreign assets made by the National Fund of the Republic of Kazakhstan had partly compensated a massive inflow of foreign direct investment. A balance of portfolio investment made by the private sector was positive, except the operations on Eurobonds of Kazakh Government, - a net receipt on this item was USD17 mln. worth.

Cost reduction of borrowing in the international capital markets stimulated private sector of the country to raise credits and loans from non-affiliated creditors. The disbursement on medium and short term loans to the banks increased 1,9 times against 2000, and that to the republic’s enterprises - 1,5 times. The government and government guaranteed external debt decreased due to that the repayment of previously raised borrowing, including the sovereign guaranteed credits, exceeded disbursement under the new borrowing.

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<sup>4</sup> Real Effective Exchange Rate of Tenge is calculated as an average weighted change of the exchange rates of Tenge vis-à-vis currencies of 20 countries – main trade partners, covering 87% of an official trade turnover of the country, and relative change of prices. Index increase/decrease implies real increase/decrease of national currency value against the currencies of other countries.

As of December 31, 2001, the gross external debt of Kazakhstan was USD14,9 bln. worth, having risen by more than USD2,3 bln. over the year. Since the liabilities on the government and government guaranteed external debt went down to USD3,8 bln., the increment of the external debt was fully due to the borrowing made by the banks and enterprises, which was not sovereign guaranteed (non-guaranteed government debt). The indebtedness of Kazakh direct investment enterprises to their parent companies accounts for over 77% of non-guaranteed external debt. By the end of 2001, the liabilities to direct investors (inter-company indebtedness) was USD8,6 bln., having surged by USD1,7 bln. over the year. Estimating a burden of external indebtedness of the country, it should be noted that a primary aim of direct investment is a long-term interest in the operations of its subsidiary, and that requirements on the volumes and maturity of such lending are often bound to the profits made by subsidiary. Nevertheless, the low default risk of such loans does not diminish a significance of such debt category, as debt repayments affect the opportunities of debt servicing from current income of other external borrowing. Non-guaranteed debt liabilities to the non-affiliated creditors (except the liabilities to direct investors) increased by more than one third – by the end of 2001 these liabilities were estimated at USD2,4 bln. Medium and short term liabilities contributed equally to the growth of debt. At the end of 2001 a share of short term debt liabilities was about 45% of this debt category.

Table 1.3.3 shows dynamics of gross external debt since 1996 by main categories of the external debt accounting for revised external indebtedness to the direct investors.

*Table 1.3.3*

**Dynamics of Gross External Debt, USD mln., end of period**

	1997	1998	1999	2000	2001
Government and government guaranteed external debt	3 290,0	4 007,0	4 055,6	3929,5	3799,9
In % of total	42,5	40,3	33,6	31,3	25,5
Non-guaranteed debt	4 459,5	5 925,2	8025,3	8636,6	11105,3
In % of total	57,5	59,7	66,4	68,7	74,5
Of which inter-company indebtedness	2 504,1	3 371,9	6 162,6	6 912,9	8615,8
In %of total	32,3	33,9	51,0	55,0	57,8
Total	7 749,5	9 932,2	12 080,9	12566,1	14905,2

The expenditures on external debt amortization and service were USD6,2 bln. worth in 2001, having risen by 21% as compared with 2000. The debt service increased mostly due to the increased external debt servicing by direct investment enterprises – in 2001 the enterprises repaid their debts to the direct foreign investors in the amount of USD2,1 bln., or 14% more than in 2000. The main parameters of the republic's external debt for three last years are demonstrated in Table 1.3.4.

*Table 1.3.4*

**External Debt of the Republic of Kazakhstan: Absolute and Relative Parameters**

	1999	2000	2001
<b>A. Absolute parameters, USD mln.</b>			
1. Gross External Debt, end of period	12081	12566	14905
Of which inter-company indebtedness	6263	6912	8616
2. Consolidated Accrued Debt Service Payments:	1890	5144	6219
Of which inter-company indebtedness	655	1898	2165
<b>B. Relative Parameters</b>			
1. Gross External Debt per Capita, USD	808	847	1006
2. Gross External Debt in % of GDP	71,6	68,9	66,7
3. Gross External Debt in % of Exports of Commodities and Services	174,7	120,6	143,4
4. Debt Service in %% of Exports of Commodities and Services	27,3	50,8	59,8
5. Payments and Interest in % of Exports of Commodities and Services	4,7	6,9	6,6
<b>Memo:</b>			
Average annual number of people, mln. persons	15,0	14,8	14,8
GDP, USD bln.	16,87	18,25	22,36

## II. MONETARY AND FOREIGN EXCHANGE POLICY

### 2.1. Monetary Policy

The monetary policy adhered by the National Bank of the Republic of Kazakhstan in 2001 was aimed at maintaining low inflation. Simultaneously, an increase of money supply adequate to the economic growth and production expansion was a policy priority.

Accordingly, within the framework of implementing these tasks the National Bank of Kazakhstan was, from one hand, to pursue the policy of constraining price growth, and, from other hand, to soften its monetary policy gradually using the instruments of indirect regulation in order to expand money supply. In overall, in 2001 the National Bank of the Republic of Kazakhstan achieved the objectives put forward, maintaining further free floating Tenge rate.

In 2001, *an annual inflation* calculated based on a consumer price index was 6,4% (December over December), having been brought down from 9,8% in 2000. The achieved level complies with the objectives put forward by the National Bank of the Republic of Kazakhstan, and is below the inflation target planned for 2001 jointly with the Government of the Republic of Kazakhstan.

Exchange rate stability (*Tenge depreciated 3,8% against US dollar*), a reduction of inflation elasticity and monetary aggregates, deepening progress in the financial sector as well as an increased trust to the adhered policy, consistent actions undertaken by the National Bank of Kazakhstan and transparency were the major factors, which promoted inflation reduction in 2001. As a result, the inflation expectations in the economy have fallen considerably in 2001.

An adequate expansion of money supply given the economic growth is one of main conditions to maintain sustainable perspective development of the economy. Accordingly, the National Bank of the Republic of Kazakhstan actively conducted a policy to increase money supply in the country. In result, in 2001 the following developments took place:

- the monetary base grew up by 30,2% to 175 bln. Tenge, of which currency in circulation (M0) rose by 23,3% to 131,2 bln. Tenge;
- the broad money (M3) increased by 43,3% to 569,1 bln. Tenge.

Along with favorable macroeconomic situation further softening of monetary policy by the National Bank of the Republic of Kazakhstan promoted an increase of money supply. Accounting for inflation and situation in the financial markets the National Bank of Kazakhstan reduced step-by-step the *official rates* during the year. The re-financing rate was reduced from 14% down to 9%, an official discount rate – from 12,5% to 8%, and overnight loan rate – from 17% down to 12%.

The level of *monetary base* (reserve money) remained one of the main operational indicators used by the National Bank of Kazakhstan in its monetary policy. An expansion of monetary base was mainly due to an increase of the net international reserves, driven by the increased foreign currency on the accounts of the Ministry of Finance of the Republic of Kazakhstan at the National Bank of Kazakhstan as well as purchases of foreign exchange, made by the National Bank in the domestic forex market.

The size of monetary base was regulated by indirect instruments exclusively. Alongside, the change of monetary base size during the year was traditionally seasonal. The maximum rate of squeeze (by 7%) was recorded in January. The maximum rate of expansion (by 11,3%) observed in December was due to a sharp reduction of Government deposits in the National Bank of Kazakhstan (due to a seasonal growth of Government spending at the end of the year).

An increase of *currency in circulation (M0)* in 2001 by 23,3% was mostly due to a significant surge of nominal and real incomes of population (high growth of wages, increased pensions and allowances, etc.) driven by favorable macroeconomic conditions. The maximum growth of currency in circulation was recorded as usual, in December (by 12,1%) being caused, along with seasonal factor, by that late November, 2001 the Ministry of Finance of Kazakhstan paid off the arrears in social sphere drawn from the past years.

A growth of *broad money (M3)* recorded in 2001 outpaced the growth rates of other monetary aggregates. Broad money rose up to 569,1 bln. Tenge. As a result, the monetization of economy increased during the year from 15,3% to 17,3%, the highest level ever occurred in the economy since independence.

An action on capital amnesty held by the government in June-July 2001 promoted an upsurge of broad money in 2001. Due to the inflow of deposits into the banking system caused by this action, a maximum increase (by 13,5%) of broad money fell on June. In its turn, the continuing growth of bank resource base facilitated an increased activity of the banks in the credit market. Thus, the banking system claims to other sectors of economy (except the Government of the Republic of Kazakhstan) rose by 86,7%. This rise, despite reduced net claims of banking system on the Government of the Republic of Kazakhstan (by 37,6%) and decreased net other internal assets of banking system (by 36,9%), promoted more than 2,8 times increase of banking system internal assets (excluding the assets of the National Fund of the Republic of Kazakhstan).

Thus, the rise of broad money was to a larger extent due to an increase of internal assets in the banking system, and to a smaller extent – to an increase of net external assets of the banking system (by 3,6%).

Due to an outpacing growth of deposits as compared with currency in circulation, the structure of broad money retained a positive trend of growing share of the bank deposits. During 2001 this indicator went up from 73,2% to 77,0%, invoking an increase of money multiplier from 2,95 to 3,25.

The operations in the open market and issuance of own short-term notes were *main instruments of the National Bank* to regulate liquidity.

In 2001, the National Bank of Kazakhstan launched the works to determine new directions in the process of liquidity regulation. The regulation accents will be gradually shifted on operations in the money market. Doing so, the National Bank of Kazakhstan increased considerably the amount of operations in the open market. Since early year, the volume of REPO operations rose by 49,1% to 78,1 bln. Tenge, and that of back REPO operations increased more than three times amounting to 37,6 bln. Tenge. An increase of REPO operation volume was accompanied by a reduction of both purchases and sales of the government securities of the Ministry of Finance in the secondary market, undertaken by the National Bank of Kazakhstan. The volume of sales was 75% of that in 2000 (13,5 bln. Tenge), and purchases were 3% only (470,8 mln. Tenge).

Due to the increased operations in the open market, the National Bank reduced notes' issue in 2001 by 12,2% to 116,4 bln. Tenge, and the notes in circulation decreased 2,8 times amounting to 17,6 bln. Tenge. The average weighted effective yields of the notes fell from 9,11% to 5,91% within the year. Despite the reduced issuance and circulation, the short-term notes remained a main instrument for liquidity regulation in 2001.

In above, the National Bank of Kazakhstan used other regulation instruments, which do not pose significant effect on money market so far, due to a relatively small volume of operations. Such instruments included the bill rediscount operations, first of all, as well as loans extended by the National Bank of Kazakhstan.

In 2001 the National Bank of Kazakhstan launched the works to put bill rediscount system into practice. A number of the first-class issuers was increased from 2 to 4 (“Kazatomprom” Close Joint Stock Company (CJSC), “Kazakhtelecom” Open Joint Stock

Company (OJSC), “Kazakhstan Temir Zholy” Republican State Enterprise (RSE), and “Kazakhstan Electricity Grid Organizing Company” OJSC). The National Bank of Kazakhstan made General Agreements on bill rediscount with 13 banks. In total, 181 bills of “Kazatomprom” CJSC amounting to 122,1 mln. Tenge were accepted for rediscounting and repaid in 2001 (from the rediscounting offices “Bank TuranAlem” OJSC and “Kazkommertzbank” OJSC with one to two months maturity). The balance of the accepted for rediscounting outstanding bills amounted to 7,1 mln. Tenge as of January 1, 2002.

In 2001 the National Bank of Kazakhstan extended 10 loans in total amount of 601,2 mln. Tenge. Repayment of bank loans in 2001 was 816,5 mln. Tenge worth. Besides, in December 2001, pursuant the Guarantee agreement dated November 28 2000 №383/1, “Nauryzbank” OJSC (a legal successor “Kazakhstan Joint Stock Agroindustrial bank” OJSC) paid off the regress claims of the National Bank of Kazakhstan in the amount of 563,8 mln. Tenge. As of January 1, 2002, a total amount of extended bank loans was 1542,5 mln. Tenge, including lending of the bank consortium members, which credit gold mining industry - 1214,3 mln. Tenge, and Kazakhstan Interbank Settlement Center - 328,2 mln. Tenge.

Classification of loan portfolio was carried out monthly. A provision 2579 mln. Tenge worth was made in order to cover possible losses under the loan extended in 2001 to the “National Saving Bank of Kazakhstan” OJSC to buy the claims on deposits held by individuals and deposits made from the pension assets of “Komirbank” OJSC.

In accordance with the Rules on extending loans by the National Bank of Kazakhstan, the agreements were made with 19 second-tier banks on issuing the “overnight” loans.

Due to that a process of borrower liquidation was completed and loss loans accounting period expired, pursuant the regulatory acts, the indebtedness to the National Bank of Kazakhstan drawn from past years was cancelled in total amount of 637 mln. Tenge, and the borrowers paid off bank loss loans in the amount of 9,4 mln. Tenge.

The arrears on overdue bank loans, which could not be written-off because their write-off did not become due yet, were 1,8 bln. Tenge worth by the end of 2001.

Pursuant the decree of the National Bank’s Board “On arrears of the Ministry of Finance of Kazakhstan to the National Bank of Kazakhstan” a residual debt of the Republican State Enterprise “State Rehabilitation Fund of the Republic of Kazakhstan” in the amount of 4,7 bln. Tenge was written-off. An agreement was made with RSE “Kazvoentorgsnabsbyt” to reschedule the overdue past years arrears of the military trade enterprises in the amount of 54 mln. Tenge.

For the purpose of monetary policy a *monitoring of real sector* is held based on the market survey questionnaires. Since the monitoring was launched, a number of participants covered by survey increased twice (from 406 to 812). These are mostly large and medium enterprises in the sectors of industry, construction, transport and communications, and agriculture. The largest number of survey participants is located in Eastern Kazakhstan, Kyzyl-Orda, Northern Kazakhstan, Zhambyl, Western Kazakhstan oblasts and Almaty city.

## **2.2. Gold and Foreign Exchange Reserves**

In 2001, gross and net gold and foreign exchange assets of the National Bank of Kazakhstan were both increasing at the same rate (19,7%). By the end of year their sizes reached USD2508,0 mln. and USD2505,7 mln., respectively.

An increase of assets in freely converted currency by USD402,8 mln. and those in precious metals by USD9,2 mln. determined a change in volume of gold and foreign exchange assets.

Purchases of foreign exchange in the domestic market were fueling growth of assets’ component denominated in foreign currency. In 2001, the net purchases of foreign exchange at Kazakhstan Stock Exchange were USD104,8 mln. worth, and those at the interbank foreign exchange market - USD218,4 mln. worth.

The foreign exchange receipts of the Ministry of Finance of Kazakhstan in the amount of USD832,5 mln. have contributed to the growth of gross foreign exchange as well. Tax payments of “TengizChevroil” company (USD497,7 mln.), rent payments for space ground “Baikonur” (USD115,0 mln.), privatization receipts on “Kazakhmys” company (USD80,7 mln.), payments by National Company “Kazakhoil” (USD55,2 mln.), and receipts from sale of state stake in “Narodnyi Bank of Kazakhstan” OJSC (USD37,0 mln.) made the largest contributions.

Besides, repayments on external debt of the Government of Kazakhstan in the amount of USD395,6 mln. and foreign exchange sales to the National Fund of the Republic of Kazakhstan (USD568,0 mln.) affected the volume of gross foreign exchange assets.

A value of assets in precious metals increased due to a hike of world prices for gold.

**Operations on Managing Gold and Foreign Exchange Assets.** Management of the gold and foreign exchange assets in 2001 addressed ensuring conservation, liquidity and rise of profitability of these assets.

In the result of back REPO operations on *foreign government securities* an average residual balance of the back REPO overnight operations with the US Federal Reserve Bank was USD184,6 mln. worth, given an average interest of 4,41% per annum. There were carried out 14 deals on back REPO in US dollars, Euro and English Pounds Sterling with an average maturity of 7 days in total amount, equivalent to USD513,7 mln.

In equivalent, a portfolio of US Government bonds went up by USD134,0 mln. to USD449,0 mln., a portfolio of IFO securities reduced by USD507,4 mln. down to USD35,6 mln., a portfolio of Euro zone securities increased by USD250,5 mln. to USD363,6 mln., a portfolio of UK Government bonds contracted by USD13,8 mln. to USD57,0 mln., and a portfolio of the US and Germany Agencies’ securities rose by USD320,6 mln. up to USD330,6 mln. A structure of securities portfolio is shown in Table 2.2.1.

Table 2.2.1

Securities Portfolio Structure, %		
Security Name	As of end of 2000	As of end of 2001
US bonds	29,95	36,33
IFO securities	51,62	2,88
Bonds of Euro zone Governments	10,75	29,42
United Kingdom bonds	6,73	4,61
Securities of the US and Germany Agencies	0,95	26,75
Total:	100,00	100,00

As of 31.12.2001, the National Bank of Kazakhstan made 4 Agreements on investment management. By the end of 2001, the market value of externally managed portfolio was USD619,3 mln. worth, or 24,7% of gold and foreign exchange assets of the National Bank of Kazakhstan.

Carrying out the *operations on gold assets* the National Bank of Kazakhstan pursued a strategy to reduce the credit risks by depositing a part of external gold assets in the Bank of England. Thus, during 2001 there were carried out 337 deposit transactions in gross amount of USD3388,7 mln. at the interest of 0,94%, 4 sale options on gold in the amount of USD20,7 mln., 104 transactions on gold purchase/sale in total amount of USD23,1 mln., and 1 interest swap amounting to USD8,3 mln.

*Foreign exchange deposit transactions with counter-partners* were held within the approved limits. During 2001, the National Bank of Kazakhstan carried out 195 transactions to place foreign currency assets denominated in US dollars in total amount of USD6323,7 mln. as well as 4 transactions in Euro and 4 transactions in English Pounds Sterling in total amounts equivalent to USD15,3 mln. and USD38,8 mln., respectively.

Besides, in 2001 the National Bank of Kazakhstan raised from second-tier banks 76 deposits in US dollars in the amount of USD307,9 mln., 3 deposits in Euro and 2 deposits in Japanese Yen amounting to the equivalents of USD17,6 mln. and USD11,4 mln., respectively. Also, 61 deposits were raised from the Ministry of Finance of the Republic of Kazakhstan amounting in total to USD2488,5 mln. Total remuneration on the US dollar deposits of the Kazakh Ministry of Finance was equivalent to about 3 bln. Tenge.

102 *foreign exchange transactions* amounting to USD395,4 mln. were held in the external markets, of which 31 transactions were made to restructure portfolio of gold and forex assets amounting to USD187,5 mln. Also, since the beginning of the year the National Bank of Kazakhstan carried out 1 arbitrage foreign exchange transaction and 1 purchase of cash US dollars.

**Income Structure of Operations on Gold and Foreign Exchange Assets.** In 2001, an overall income from operations on gold and foreign exchange assets of the National Bank of Kazakhstan went up by 71,9% achieving USD192,0 mln. as compared with earnings in 2000. Consolidated data on incomes generated by operations on gold and foreign exchange assets are calculated in the US dollar equivalent against Kazakh Tenge based on the official exchange rate of the National Bank of Kazakhstan as of end of period. Income structure by types of operations is shown in Table 2.2.2.

Table 2.2.2.

<b>Income Structure based on Accrual Method, (in % of total income)</b>			
<b>№</b>	<b>Operation type</b>	<b>2000</b>	<b>2001</b>
1.	Foreign exchange transactions	11,86	2,56
2.	Money market operations	6,40	4,62
3.	Stock market operations	67,61	69,96
4.	Gold transactions	2,54	1,95
5.	External management	11,59	20,91
	Total:	100,00	100,00

In order to increase the long-term profitability of assets along with maintaining high liquidity as well as to strengthen investment discipline, gold and foreign exchange assets were conventionally divided into long-term portfolio, short-term portfolio and gold portfolio. Standard portfolio and allowable deviations based on main risks were approved for each portfolio. A Merrill Lynch 3-month US Treasury Bill Index was accepted as a standard portfolio for the short-term portfolio, and the 70% Merrill Lynch US Treasuries&Agencies 1-3 years, 25% Merrill Lynch German Federal Governments 1-3 years, 4% Merrill Lynch U.K. Gilts 1-3 years Index and 1% Merrill Lynch Japanese Governments 1-3 years was accepted for long-term portfolio.

An annual yield of the long-term independently managed portfolio in US dollars was 8,65% (yield of standard portfolio – 8,26%), that of portfolio in Euro – 4,93% (standard portfolio yield – 5,61%), that in English Pound Sterling – 6,11% (standard portfolio yield – 6,18%), and that for short-term independently managed portfolio in US dollars – 5,21% (standard portfolio yield – 4,42%).

*Credit risk management.* Classification of the assets of the National Bank of Kazakhstan and provision building was held monthly. The ratings of the counter-partners of the National Bank of Kazakhstan were monitored and respective limits were elaborated quarterly.

### **2.3. Foreign Exchange Regulations and Control**

Major activities of the National Bank of Kazakhstan addressing improvement of foreign exchange regulations in 2001 were to order the procedures of forex control, which forms an integral part of direct forex market regulation as well as to enhance the responsibility of foreign economic operators and tighten the requirements put forward for

them, because of almost lacking mechanism to sue the violators of foreign exchange legislation.

To perform the tasks put forward by the President of the Republic of Kazakhstan and Government programs, a Law “On amendments and additions to some legislative acts of the Republic of Kazakhstan on foreign exchange regulation” was drafted and adopted, and became effective since February 2, 2001.

To implement this law, a package of regulatory acts on forex regulation and control was worked out and adopted, including in particular:

The Rules on carrying out forex transactions in the Republic of Kazakhstan (a new edition is approved by the Decree of the Board of the National Bank of Kazakhstan on 20.04.01, №115),

The Rules on registration of forex transactions related to capital movement (a new edition is approved by the Decree of the Board of the National Bank of Kazakhstan on 31.03.01, №88),

The Rules on licensing the use of forex valuables (a new edition is approved by the Decree of the Board of the National Bank of Kazakhstan on 06.08.01, №306),

Instruction on organizing export-import forex control in the Republic of Kazakhstan (a new edition is approved by the Decree of the Board of the National Bank of Kazakhstan on 05.09.01r. №343),

Additions and amendments to the Instruction on organizing exchange operations in cash foreign currency in the Republic of Kazakhstan (approved by the Decrees of the Board of the National Bank of Kazakhstan on 20.04.01, №111 and 01.12.01, №478),

Additions to the Rules on organizing and implementing checks of the enforcement of foreign exchange legislation of the Republic of Kazakhstan (approved by the Decree of the Board of the National Bank of Kazakhstan on 02.06.01, №188).

***Main changes in foreign exchange legislation.*** A definition of “foreign exchange legislation” was made, since formerly, due to a lack of such definition, it was difficult to make the violators answerable. The national currency engaged in transactions between the residents and non-residents is considered a currency valuable. By this, such transactions in Tenge are subject to forex control similarly to the transactions in foreign currency. The measures were undertaken to ensure security of cash forex offices, in particular, the requirements to their premises and technical equipment were tightened. In order to reduce duration of capital circulation outside the republic, the terms of current forex transactions were decreased from 180 days to 120 days.

The resident legal entities got additional grounds to purchase foreign exchange in the domestic market, and non-resident legal entities are not restricted any more in purchasing foreign currency.

A sustainable growth of cash forex market enabled to increase a norm of cash foreign currency, which the individuals may take out of the country from the equivalent of 3 thousand to that of 10 thousand of the US dollars. A norm of one-time bank transfer in foreign currency through the authorized bank was also increased up to an equivalent of 10 thousand US dollars.

The amendments made in foreign exchange legislation eliminated a requirement of obligatory certificate issued under exchange transactions in cash foreign currency carried out by cash forex offices. At present, the certificate is issued on clients’ demand. Alongside, not only personal identification document, but business passport and military ID are acceptable as well. Such simplified order of carrying out exchange transactions is practically a unique example in CIS region.

Some types of forex transactions are exempted of excessive control by the regulatory bodies making them more attractive. In particular, for the transactions employing

documentary payments and for the agreements on non-government external loans, raised under the government guarantee, certain graceful terms were introduced in using foreign currency, if the latter is purchased in the domestic market.

The new rules on licensing the activities, which involve forex valuables, considerably shortened a list of operations subject to licensing. Also, in order to simplify licensing procedures, a list of regulatory bodies necessarily endorsing license issuance and a list of documents to be submitted by license applicant were reduced.

To ensure reliable and full statistical accounting as well as to prevent abuses in overestimating financial liabilities to the non-residents, the Rules on registration of forex transactions stipulate that the National Bank of Kazakhstan provides data on the registered deals to the banks and Customs Committee. The second-tier banks are to provide an information on capital movement under the registered contracts to the National Bank of Kazakhstan.

In 2001, an improvement of export-import control was continued. Due to that the National Bank of Kazakhstan does not have reliable information on shortfalls of export receipts and imported commodities because of insufficient technical capacity of customs bodies, a new Instruction was adopted on organizing export-import control. In order to implement a scheme of export-import forex control, specified by this Instruction, an elaboration of the automated information system to maintain forex control was launched.

***Licensing and administration in part of violations of foreign exchange legislation.***

In 2001 the following licenses were issued:

57 licenses were issued to the corporate residents of Kazakhstan to open accounts in foreign banks located abroad;

1152 licenses were issued to carry out transactions related to capital movement;

366 licenses were extended to carry out transactions, in which the terms of export receipt for the delivered by the residents commodities/services might exceed 120 days since shipment date;

202 licenses were issued to carry out exchange transactions in cash foreign currency (as of January 1, 2002 a number of existing cash forex offices was 2436).

After effectiveness of the Administrative Code of the Republic of Kazakhstan on February 25 2001, which stipulated administrative responsibility of the legal entities and individuals for violating norms of foreign exchange legislation, the following cases were recorded as of January 1, 2002 (including the regional branches of the National Bank of Kazakhstan):

817 cases on administrative violations were reviewed, including materials based on which 376 suits on administrative violations were instituted;

the National Bank of Kazakhstan reviewed 141 cases, in which penalty sanctions in total amount of 9,4 bln. Tenge were imposed.

### III. REGULATIONS OF CASH FLOWS

**Issuance and cash flows.** In 2001, cash currency in the amount of 235,4 bln. Tenge out of reserves of the National Bank of Kazakhstan were issued, including emission of 97,4 bln. Tenge worth and withdrawal of 206,3 bln. Tenge worth out of circulation. Net cash issuance rose 4,8 times and amounted to 29,1 bln. Tenge in 2001. Cash emission increase was due to an enlarged activity of economic operators and accordingly growth of their needs in cash.

As of January 1, 2002 there were 131,2 bln. Tenge worth in circulation (Annex 3).

Cash received by second-tier banks increased in 2001 by 24% as compared with 2000 and reached 1529,4 bln. Tenge, and paid out cash amounts rose by 27% achieving 1546,6 bln. Tenge. An increase of cash flows was recorded for all inflow and outflow items.

Positive issuance results were recorded in all oblasts, except Almaty city. The volumes of withdrawn cash throughout Almaty city in 2001 increased by 9,3 bln. Tenge and were 100,8 bln. Tenge, witnessing a rise of cash migration into Almaty from other regions of the country. Zhambyl and South Kazakhstan were the only regions, which saw decline of issuance. Like previously, Eastern Kazakhstan and Karaganda oblasts were issuing largest cash volumes. Cash issuance increased considerably in Eastern Kazakhstan oblast (by 80% up to 24,8 bln. Tenge), in Atyrau oblast - by 41% up to 14,2 bln. Tenge, and in Pavlodar oblast the issuance more than doubled reaching 6,8 bln. Tenge. The remaining oblasts showed less increase of issuance volumes.

**Withdrawal of banknotes and coins, destruction of worn banknotes and forgery prevention.** During 2001 worn banknotes were destroyed more actively. To destroy withdrawn outdated and worn banknotes pursuant planned schedule, the National Bank of Kazakhstan acquired an improved automated banknote destruction system. In 2001, there were destroyed 60,4 bln. Tenge, which account for 80% of total volume of the destroyed banknotes since introduction of the national currency (75,9 bln. Tenge). The National Bank of Kazakhstan continued in 2001 to maintain quality of national currency notes. In particular, withdrawal of the banknotes of nominal value ranging from 1 to 50 Tenge with subsequent substitution by coins was continued. The amount of banknotes of 1 to 50 Tenge nominal value withdrawn during 2001 was 827,9 mln. Tenge worth, and thus, there were only 554,7 mln. Tenge of such nominal banknotes circulating as of January 1, 2002. Tenge (4% of total amount of banknotes having such nominal value ever produced). The withdrawal rate were decreasing during 2001, demonstrating gradually completing withdrawal of banknotes of such nominal value.

To ensure cash flows of small nominal value, the National Bank of Kazakhstan timely furnished the second-tier banks with change coins. During 2001, an amount of circulated coins increased by 1,3 bln. Tenge and reached 2,8 bln. Tenge.

The Edict of the President of the Republic of Kazakhstan and the Decree of the Board of the National Bank of Kazakhstan abolished circulation of tiyn and circulation coins (Tenge) of 1993 issue, respectively.

The period of simultaneous circulation of new and old banknotes “200 Tenge” and “500 Tenge” expired on September 1, 2001. During this period 92,8% of old format banknotes were withdrawn.

An expertise on 2418 doubtful banknotes was held in 2001. The measures to improve technical and information capacity of the branches of the National Bank of Kazakhstan addressing prevention and forgery elimination were prepared.

**Issuance of new format banknotes, jubilee and memorial coins.** In 2001 the National Bank of Kazakhstan introduced new format banknotes of “1000 Tenge” and “2000 Tenge” nominal value with strengthened protection elements, as well as a circulation banknote of “5000 Tenge” nominal value of 2001 format with partly changed design.

Pursuant the Concept of jubilee and memorial coins for 2000 – 2005 the following coins were issued in 2001:

Memorial silver coins (925/1000) of “500 Tenge” nominal value in the amount of 3000 pieces of each series: “Snow leopard” and “Saigak” out of series “Red Book of Kazakhstan”, “Narkobyz” (series “Applied arts”), and “Umai” (“Petroglyphs of Kazakhstan”);

Memorial golden coin (999/1000) “Altyn Adam” out of series “Architectural and historical memorials” of “1000 Tenge” nominal value in the amount of 2000 pieces.

Three types of jubilee coins were issued in honor of 10-th anniversary of Kazakhstan independence: 50 thousand nuesilber coins of “50 Tenge” nominal value, 3 thousand silver (925/1000) coins of “500 Tenge” nominal value, and 100 silver (925/1000) coins of “5000 Tenge” nominal value. Also, banknotes of “5000 Tenge” nominal value in 2001 format containing a jubilee writing devoted to 10-th anniversary of Kazakhstan independence (one million pieces) were issued.

## IV. FINANCIAL MARKET

### 4.1. Foreign Exchange Market

The tendencies evolved in the domestic foreign exchange market during 2001 were mostly due to further strengthening of positive trends in economic development of Kazakhstan. The relative stability of country's main exports, which furnish major forex inflow to the domestic market facilitated sustainability of forex market.

In the course of 2001 the National Bank of Kazakhstan was purchasing as well as selling foreign exchange. In overall, the purchases of the US dollars exceeded sales replenishing gold and forex reserves of the country.

By the end of 2001, one US dollar costed 150,94 Tenge and an annual average weighted exchange rate of Tenge vis-à-vis US dollar was 147,22 Tenge.

US dollar was a main currency of conversion transactions. In 2001, the volume of market trades of US dollar was USD1952,0 mln., having exceeded 2000 level by 12,8%.

The turnover of the interbank currency market exceeded that at KASE considerably: a volume of deals between resident banks in the interbank currency market reached the equivalent of USD3647,8 mln., having risen by 13,8% over the year.

The shares of trades on Deutsche Mark and Euro were small at both KASE and interbank segments of forex market and continued to decline. Trades on Deutsche Mark and Euro at KASE squeezed 21,1 and 8,5 times, amounting to 45 thousand DM and 85 thousand Euro, respectively. The conversion transactions on Deutsche Mark at the interbank market declined by 16,2% down to 18,5 mln. DM, whereas the trades on Euro went up by 67,6% and reached 18,2 mln. Euro.

In 2001, the trades on Russian Ruble, suspended in 1997, were resumed at KASE. The volume of transactions on Russian Ruble was 86,2 mln. RR in 2001.

Russian Ruble was traded mostly at the interbank currency market resulting accordingly in an increased share of transactions, carried out by resident banks. A volume of transactions in 2001 upsurged by 57,2% against 2000 and amounted to 1023,8 mln. Russian Rubles.

Like in previous years, US dollar was a preferable cash foreign currency, and, accordingly, purchases of this foreign currency dominated in this segment of market.

In 2001, the cash forex offices sold USD2369 mln., showing an increase by 2,2% as compared with the previous year. The monthly average sales by cash forex offices grew up by USD6 mln. and amounted to USD197 mln.

Thus, despite a slowdown of the world economy growth, reduction of the world prices for major Kazakhstani exports, worsening terms of trade and current account in the country's balance of payments, the national currency remains stable. Tenge depreciated 3,8% in 2001, showing the lowest level ever recorded in the history of republic's independence. This evidences an increasingly strengthened trust to Tenge and confidence in stability of national currency from the population, domestic and foreign investors.

### 4.2. Interbank Money Market

In 2001 the interbank money market functioned steadily, and short-term borrowing in this market segment was a main instrument to regulate current liquidity of the banks. The banks were actively raising and placing short-term Tenge denominated deposits, whereas the interbank credits in national currency were not issued practically. A total volume of placed interbank Tenge deposits went up by 25,6% as compared with 2000 and amounted to 241,5 bln. Tenge. An average annual yield of interbank deposits in Tenge was 5,72% (in 2000 – 7,15%).

The banks were very active in the interbank market of forex instruments, as well. Thus, interbank dollar deposits, which form a main type of short-term forex operations employed by the banks, amounted to USD17,1 bln. (in 2000 – USD10,5 bln.). Deposits in Euro made by the banks were 1,8 bln. Euro worth, showing a 2,2 times hike against 2000.

Other interbank borrowings in foreign currency were small.

Dynamics of yields on interbank borrowing in foreign currency showed a sustainable down trend. An average weighted interest on deposits in US dollars was 3,10% in December 2001 (in December 2000 – 6,42%), and that in Euro – 3,01% (in December 2000 – 4,60%).

### 4.3. Deposit and Credit Market

In overall, situation in the deposit and credit markets was most favorable in 2001 throughout the whole period of financial market development. Positive tendencies in the country's economy strengthened, a one-time capital amnesty was held, a system of individuals' deposit insurance was improved further and real incomes of population increased.

Situation in *deposit market* was characterized by a successive growth of resource base of banks. Resident deposits with the banking system rose by 50,7% and reached 437,9 bln. Tenge (foreign currency equivalent – over USD2,9 bln.).

Corporate deposits grew up by 25,1% and were 253,1 bln. Tenge worth by the end of 2001. Call deposits accounted for over a half of corporate deposits (53%). Accordingly, from time to time the legal entities were withdrawing their money from deposits, especially, call deposits to carry out current transactions situations.

A positive trend of increasing individuals' deposits with the banking system was retained. In average, the deposits were growing by 4-5 bln. Tenge per month (in 2000 – about 3 bln. Tenge).

An action on capital amnesty held in June-July was a significant event, enabling the bank system to raise additional resources. As a result of this action, about USD480 mln. were legalized. According to the estimates of the National Bank of Kazakhstan, about 60% of all legalized by citizens money were deposited on bank accounts.

In result, in overall in 2001 the population deposits (including non-residents) more than doubled and amounted to 185,5 bln. Tenge (foreign currency equivalent – over USD1,2 bln.).

Structure of individuals' deposits showed a positive feature of an outpacing growth of time deposits as compared with call deposits and current accounts (Figure 4.3.1). Time deposits hiked 2,3 times during the year and amounted to 146,8 bln. Tenge, call deposits (including current accounts) rose by 43,7% and reached 38,6 bln. Tenge. As a result, a share of time deposits held by individuals increased from 70,7% up to 79,2%.

Macroeconomic improvement and inflation slowdown conditioned a reduction of nominal interest rates on raised deposits. In 2001, an average weighted interest on Tenge time deposits held by individuals went down from 15,6% to 12,8%, and that on deposits in foreign currency – from 8,6% down to 7,3%. Gradual reduction of deposit rates promoted downward trend of bank credit interest.

Given the favorable macroeconomic environment and continuing growth of deposit base, the banks have considerably increased their activities in the *credit market*. A total volume of bank lending to the economy in 2001 rose by 77,3% and amounted to 489,8 bln. Tenge (foreign currency equivalent – over USD3,2 bln.). Alongside, a share of credits extended to the economy increased from 52,3% to 60% in a structure of bank assets

Given total growth of lending to the real sector of the economy, an outpacing growth of lending in foreign currency continued in 2001 (Figure 4.3.2.). Lending in national currency rose in 2001 by 4,4% and amounted to 141,2 bln. Tenge, and that in foreign currency increased 2,5 times and was 348,6 bln. Tenge worth or USD2,3 bln. As a result, a share of

Tenge credits declined from 49,0% to 28,8%. An increased share of credits denominated in foreign currency was due to a rise of foreign currency liabilities share in a structure of resource base.

Figure 4.3.1

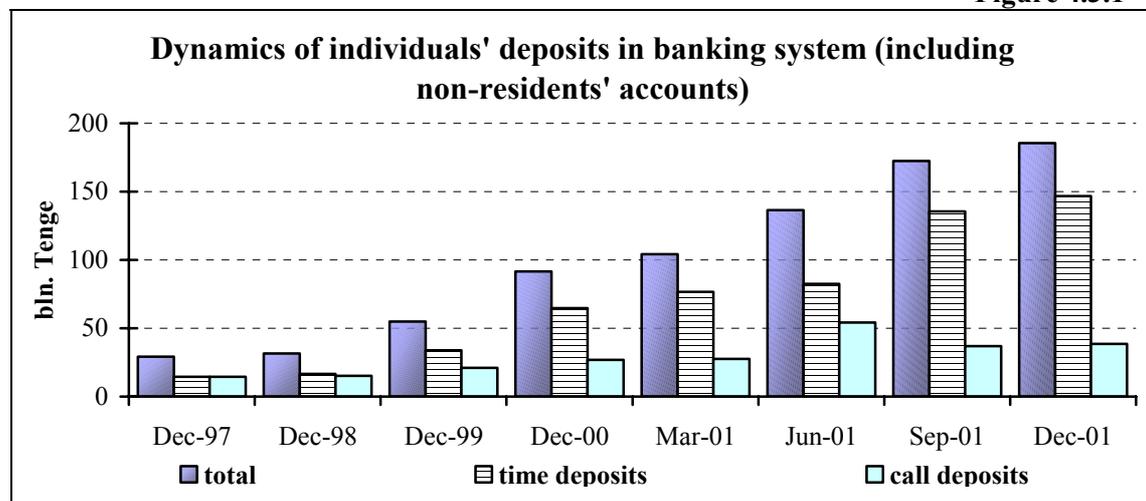
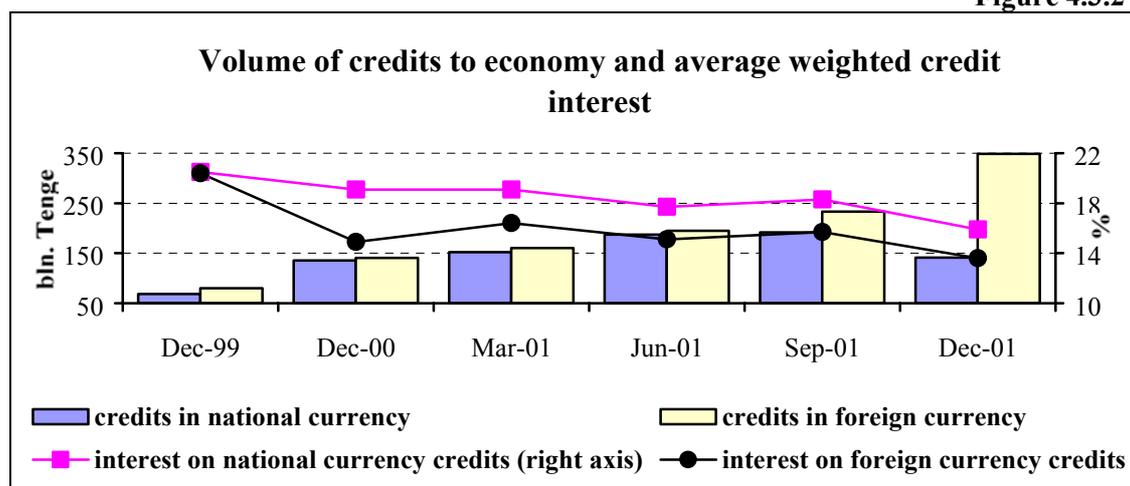


Figure 4.3.2



During 2001, positive changes occurred in credit structure, where medium and long term lending grew faster than that short-term. Medium and long term credits rose by 86,9% and amounted to 248,7 bln. Tenge, and the short-term loans increased by 68,4% and were 241,1 bln. Tenge worth. A share of medium and long term credits went up from 48,2% to 50,8% in 2001.

Corporate clients of banks – enterprises and organizations – remained the main bank borrowers. Alongside, a share of credits extended to corporate clients in total lending to the economy lending during last year decreased from 94,7% to 93,7%, whereas a share of credits issued to the individuals rose from 5,3% to 6,3%. Although the latter rise is small, it is assessed positively, as it demonstrates expansion of credit services the banks offer to population.

The volume of credits extended to small business went up by 64,3% and amounted to about 122 bln. Tenge or 24,9% of total lending to the economy during 2001.

Given improved macroeconomic conditions and sustainable progress of financial sector, the reduction of re-financing rate by the National Bank of Kazakhstan promoted decline of bank credit interest. An average weighted interest on Tenge credits issued to the corporate clients went down from 18,8% to 15,4% per annum, and that for individuals - from 27% to 24,5%. The recorded corporate credit rate is the lowest in the history of country's credit market development.

#### 4.4. Securities Market

A volume of *government securities* placed by the Ministry of Finance of Kazakhstan during 2001 remained practically at the level of 2000 and amounted to 25,9 bln. Tenge, due to a low need of budget in short term borrowing.

Simultaneously, government securities market got qualitative development a variety of medium term government securities was enlarged considerably. Thus, 4-and 5-year with coupon as well as 3-, 4-, 5-, and 7-year inflation indexed government papers were introduced in the course of 2001. Given this, a share of instruments of 12 and more months maturity (excluding special ten-year obligations MEAKAM) in total amount of circulating securities issued by the Ministry of Finance rose from 81,7% as of 2000 end up to 95,8% as of end of 2001. An increased share of "lengthy" papers given the unchanged issuance volume led to a growth of a share of government (Ministry of Finance) papers in total amount of securities circulated (by 15,8% amounting to 70,6 bln. Tenge) along with yields drop. For instance, the yields on three-month securities fell 2,6 times - from 14,38 to 5,39% (average weighted yields at discount value dropped from 6,75% to 5,39% ).

*The corporate securities market* saw continuing tendency of general improvement. An increase of trade volumes on stocks and non-government obligations was one of main positive outcomes.

In 2001, purchases and sales of non-government securities at KASE doubled (over 30 bln. Tenge). The trade volumes increased on both stocks and obligations. Share of trades on obligations doubled and accounted for 60,2% of total trades on non-government securities at KASE.

The volume of REPO deals on non-government papers at KASE rose most significantly – it hiked 9 times (up to 28,0 bln. Tenge), accounting for 48,2% of total trades at KASE on non-government securities. KASE also saw a rise of primary placements of non-government securities (more than 2,5 times reaching 6,9 bln. Tenge).

In above, ten- and five percent state-owned stakes in "Kazakhmys" OJSC were traded at Kazakhstan Stock Exchange in 2001. Ten-percent state-owned stake was sold fully by a single lot, while only 17 out of 246 lots were sold out of five-percent stake offered for sale to the pensions funds. A total volume of trades on these government stakes was 9,4 bln. Tenge worth.

Increased trades of non-government papers at KASE were due to, firstly, expansion of securities quoted at KASE in the official "A" listing, and secondly, an enlarged demand for stock and non-government papers from main investors (primarily, Pension Asset Management companies).

Summarized capitalization of marketed stocks<sup>5</sup>, listed at KASE, increased during 2001 by 56,8% and was 181,6 bln. Tenge worth as of January 1, 2002. This indicator for obligations went up 4,3 times and amounted to 84,6 bln. Tenge.

The volume of deals made by brokers-dealers beyond KASE was 20,7 bln. Tenge worth, and given this, primary placement amounted to 19,6 bln. Tenge.

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<sup>5</sup> Since July 1, 2001 stock capitalization is calculated as a sum of market value of only those companies, which stocks are officially listed at Kazakhstan Stock Exchange.

#### 4.5. Accumulation Pension System

Accumulation pension system progressed dynamically, and in July 2001 (3,5 years since pension reform was launched) total pension assets were over USD1 bln. Growth of pension assets generated hiked demand in the securities market encouraging the enterprises to increase considerably the issue of their obligations.

By the end of 2001, 15 accumulation pension funds (1 state and 14 private), 7 pension asset managing companies and 11 custodian banks operated in Kazakhstan.

In 2001, the assets of pension funds increased by 61,9% and amounted to 182,4 bln. Tenge, or USD1,2 bln. in foreign currency equivalent (Table 4.5.1).

Structure of pension funds' portfolio as of January 1, 2002 is shown in Table 4.5.2. Major bulk of assets is invested in government securities. However a share of non-government securities in the investment portfolio of private pension funds grew up considerably – from 26,9% to 39,7% (State accumulation pension fund is not entitled to invest pension assets in this very instrument).

*Table 4.5.1*

	<b>As of 01.01.99</b>	<b>As of 01.01.00</b>	<b>As of 01.01.01</b>	<b>As of 01.01.02</b>
Private Pension Accumulation Funds	5,59	30,64	68,79	123,49
State Pension Accumulation Fund	17,95	33,87	43,86	58,88
<b>Total</b>	<b>23,54</b>	<b>64,51</b>	<b>112,65</b>	<b>182,38</b>

*Table 4.5.2*

**Accumulation Pension Funds: Structure of Investment Portfolio  
(as of January 1, 2002), %**

	<b>All Funds</b>	<b>State Accumulation Pension Fund</b>	<b>Private Accumulation Pension Funds</b>
Government securities	60,81	69,7	56,6
including:			
Eurobonds of Republic of Kazakhstan	44,1	45,7	43,3
Government securities	16,1	23,9	12,4
Local government obligations	0,7	0,1	0,9
IFO securities	3,7	9,6	0,8
Non-government securities	26,9	0,0	39,7
Bank deposits	8,7	20,9	2,9

In 2001 the National Bank of Kazakhstan worked consistently to expand the opportunities of the pension asset managing companies to invest pension assets. A share of pension assets, the private pensions funds are allowed to invest in non-government securities, was brought up from 40% to 45%, in securities of foreign companies - from 10% to 15%, and new limits were established for investment in mortgage obligations of domestic enterprises (not more than 5%) and obligations of "Development Bank of Kazakhstan" CJSC (not more than 5%).

The investment limits for the State Accumulation Pension Fund saw no changes in 2001.

## V. FINANCIAL INSTITUTIONS AND SUPERVISORY FUNCTIONS

### 5.1. Banking Sector<sup>6</sup> (Annex 4)

Consolidation and strengthening continued in the banking sector in 2001. As a result, a total number of second-tier banks went down from 48 to 44 during the last year. A share of assets of two state-owned banks ("Eximbank Kazakhstan" CJSC and "Development Bank of Kazakhstan" CJSC) and one inter-state bank ("Central Asian Bank for Cooperation and Development" CJSC) in consolidated assets of banking sector was small during 2001 and accounted for 3,5% by the end of year.

Implementation of Program on transition of second-tier banks to the international standards was continued in 2001. The Program was approved by the Decree of the Board of the National Bank of Kazakhstan on 12.12.96, № 292. In 2001, a number of banks, which proved their compliance with the requirements set by the mentioned above Program increased from 1 to 12, and a number of failed banks went down to 4 from 7. The banks, which were recognized to meet the Program's requirements as well as the banks, which were classified by the Program under the first and second groups, increased their share in consolidated banking sector assets from 89,1% to 90,5%.

Currently, in accordance with the banking international standards the efficient risk management systems are recognized as the best world practices. In this regard, pursuant the Decree of the Board of the National Bank of Kazakhstan dated December 20, 2001 № 567, the banks have to undertake measures to create the efficient risk management systems with the procedures compliant with recognized international practice and recommendations provided by the National Bank of Kazakhstan, and are to submit a respective auditor's confirmation to the National Bank of Kazakhstan before April 1, 2003.

At present, the National Bank of Kazakhstan undertakes the appropriate measures to reorganize the banks, which failed to meet the requirements of the mentioned above Program, into the credit partnerships or liquidate them in a compulsory manner.

Like previously, in 2001 eight banks were awarded credit ratings by the International Rating Agencies. A share of assets of such banks in consolidated banking system assets increased during 2001 from 66,9% to 73%.

**Bank capital<sup>7</sup>.** As of January 1 2002, consolidated equity capital of the Kazakhstani banks was 122,3 bln. Tenge worth (foreign currency equivalent – USD809 mln.), having risen by 24,7 bln. Tenge or by 25,3%.

Equity capital of the banks increased due to the following factors. Firstly, due to an increase of the consolidated banking system assets, including growth of the banks' risk assets more than 1,5 times, the banks had to maintain in the course of the year their equity capital at the level adequate to their risk assets. Secondly, a rise of bank equity capital is due to an active growth of subordinated liabilities of the banks. Thirdly, banking sector capitalization increased due to the enhanced requirements on the bank's minimal authorized and equity capital, which were changed by the Decree of the National Bank of Kazakhstan (02.06.2001, № 190) as follows. The minimal required bank authorized capital was established at 2 bln. Tenge, and minimal required equity capital - at 1 bln. Tenge, including that for the regional banks – at 0,5 bln. Tenge.

Equity capital of banking system was increased largely due to a growth of first-level capital - 17,7%, which, in its turn, was due to an increase of consolidated banks' authorized capital by 8,1 bln. Tenge. The retained profits received by the banks in 2001 was 8,7 bln. Tenge worth, having overcome the last year indicator by 77,6%.

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<sup>6</sup> Provided data on financial statements exclude conclusive balances.

<sup>7</sup> In this section, bank capital is calculated pursuant the Rules on prudential norms approved by the Decree of the Board of the National Bank of Kazakhstan on 23.05.1997, № 219.

A rise of second-level capital by 41,8% was due to the banks' current income of 6,6 bln. Tenge and growth of subordinated bank liabilities in the amount of 5,2 bln. Tenge.

A share of domestic capital in a structure of consolidated banks' authorized capital went up from 77% to 82,4%. Given this, a share of state-owned stake in consolidated equity capital of the banking system showed a rise from 10,9% to 31,6%, mostly due to "Development Bank of Kazakhstan" CJSC, which was established and launched its operations in 2001.

A share of foreign capital in consolidated banking system capital squeezed from 23,2% to 17,6%. Structure of banking system authorized capital by ownership and residency is given in an Annex 4.

Despite fast growth of consolidated assets of the banking sector, which have considerably outpaced growth of equity capital, sufficiency of equity capital of the banks remained high during 2001.

**Banks' assets.** During 2001 consolidated banking sector assets rose by 54,9% and amounted to 818 bln. Tenge (equivalent of USD5,5 bln.).

A share of assets denominated in foreign currency went up from 48,4% (255,4 bln. Tenge) to 67,2% (549,7 bln. Tenge), being mainly due to foreign currency inflow into the bank system, that is, due to consolidated growth of foreign currency liabilities of the banks.

Loan portfolio of the banks saw the largest increment during 2001, accounting for 79,3% in the consolidated increment of banking system assets. Securities portfolio of the banks saw the largest drop having been reduced by 4,9 bln. Tenge in absolute terms through the year. In the course of year bank loans concentrated in such sectors of economy as agriculture (9,9% of loan portfolio), mining (8,1%), food (7,1%), construction (4,5%), and trade (23,4%).

Given considerable growth of consolidated assets, quality of assets did not change essentially in 2001. Thus, given increased 289,8 bln. Tenge consolidated assets, a share of standard assets in consolidated assets went up from 62,0% to 67,0%, that of doubtful assets rose from 12,5% to 19,6%, and that of bad assets – from 1,1% to 1,8%.

Accounting for that share of loan portfolio in a structure of consolidated dynamics of banking sector assets was 79,3%, quality of consolidated banks' assets was largely determined by quality of bank loans. A share of doubtful loans increased from 21,1% to 28,6%, and that of bad loans – from 2,1% to 2,3% by the end of 2001 as compared with the beginning of the year. Despite that a share of classified credits increased insignificantly, and a share of standard loans in consolidated credits dropped from 76,8% to 69,1%, a rise of standard credits in consolidated increment of banking system portfolio (230,1 bln. Tenge) accounted for 69,8%.

**Bank liabilities.** The consolidated liabilities of the banks increased by 57,2% during 2001 and were 686,0 bln. Tenge worth (foreign currency equivalent of the liabilities was USD4,6 bln.) as of January 1, 2002. An increment of consolidated liabilities in 2001 exceeded that of 2000 by 51% or 84,4 bln. Tenge. A share of liabilities denominated in foreign currencies in consolidated liabilities of banking system rose from 57,1% to 69,6% during the year.

All items of banking sector liabilities showed positive dynamics. Individuals' and corporate (except banks) deposits produced the largest effect on growth of consolidated liabilities. A share of deposits in a structure of consolidated liabilities of the banks increased from 70,2% to 70,3% in 2001. Revival of deposit and credit markets ensured growth of the consolidated liabilities of banking system by 63,3 bln. Tenge or 25,4% during 2001.

Deposits held by the individuals, which are covered by a system of obligatory collective individuals' deposit insurance, rose by 37,3 bln. Tenge or 62,1%. Given this, a

share of guaranteed deposits held by individuals in consolidated deposits of population with the banking system declined from 65,5% to 52,4%.

**Bank liquidity.** During 2001, the banking system saw liquidity overhang. Consolidated coefficient of current liquidity stayed at the level above 0,8 throughout whole 2001 and achieved 0,83 as of January 1, 2002 (minimal norm established by the National Bank of Kazakhstan is – 0,3). High current liquidity of the banking sector throughout 2001 was due to that liquid and fast realized assets were growing faster than call liabilities did. Besides, the banks maintained a minimal liquidity coefficient established by the National Bank of Kazakhstan for all time groups of assets and liabilities.

For all time groups a minimum ratio of assets and liabilities was 0,43 during 2001 (at the end of 2000 – 0,42). Overhang of highly liquid assets of banking system over call deposits somewhat decreased during 2001 (by 0,2 bln. Tenge), but reached 51,5 bln. Tenge as of January 1, 2002.

A share of liquid assets in consolidated banking sector assets dropped during 2001 (from 31,2% to 19,8%), and a share of call liabilities in consolidated liabilities declined from 38,5% to 27,4%.

A ratio of bank credits to the raised deposits was 1,1 as of January 1, 2002 (in 2000 this coefficient was 0,94).

**Bank income and expenditures.** Consolidated net income of banking sector after taxes was 6,6 bln. Tenge worth as of January 1, 2002 (6,7 bln. Tenge – as of January 2001), including net interest income in the amount of 43,1 bln. Tenge (27,4 bln. Tenge) and losses in other operations -36,6 bln. Tenge (- 20,7 bln. Tenge). Income generated by lending operations accounted for the largest share in an income structure of the banks (35,9%), whilst the banks incurred significant expenses due to revaluation of their liabilities and financing provisions on classified assets (18,9% and 27%, respectively).

The coefficients characterizing banking sector profitability in 2001 are somewhat higher than the indicators of 2000.

Decline of banking sector profitability in 2001 was due to increased non-interest expenses, in particular, those incurred by the banks to ensure needed level of provisions against losses on classified assets. A share of these expenses in consolidated non-interest expenses of banking system rose from 14,5 to 24% during 2001.

**Banking supervision.** In 2001 the National Bank of Kazakhstan undertook measures to bring supervisory practice of the National Bank of Kazakhstan to the international standards of banking regulation and supervision. Thus, in particular, in March 2001 banking regulatory legislation was amended empowering the National Bank of Kazakhstan to carry out consolidated supervision, and later, by the end of 2001, the National Bank of Kazakhstan approved a major bulk of documents defining the rules of consolidated supervision.

Consolidated supervision provides for identification of the bank affiliated persons, restriction of their possible negative impact on the bank's operations, control over bank's transactions with affiliated persons, as well as undertaking measures and sanctions in respect of the affiliated persons to ensure stable financial position of the bank and its compliance with the requirements of banking legislation.

**Bank licensing.** In 2001 banking licenses were extended to 4 banks, of which two banks got licenses to complete settlements with their creditors and debtors for subsequent transformation into credit partnerships, one bank was awarded a license as a newly established one, and one bank got its banking license recovered.

“No objection” was issued to open 12 and close down 12 bank branches. Besides, 223 newly opened settlement and cash departments were registered. Alongside, 155 settlement and cash departments were closed down during the year.

**Prudential supervision.** A number of banks violating prudential norms declined more than twice in 2001 as compared with 2000, and was 6 as of January 1, 2002 (13 banks on January 1, 2001). Given this, a number of banks violating all prudential norms dropped from 2 to 1.

The second-tier banks, which violated banking legislation, were imposed limit-scope measures and sanctions pursuant the existing banking legislation.

Reorganization of the banks, violating of the banking legislation and failing to perform the instructions issued by the National Bank of Kazakhstan, was continued in 2001. In particular, “Kazakhstan Industrial Bank” OJSC was reorganized through its merge with “Almaty Merchandise Financial Bank” OJSC, “Azhi-bank” OJSC was transformed into credit partnership and “TransAsian Trade Bank” OJSC was reorganized into credit-deposit partnership.

In 2001, eight Kazakhstani banks were deprived their banking licenses. A decision to revoke banking license from “Komirbank” OJSC was made due to that bank failed to meet the requirements of banking legislation, systematically unduly performed its contract liabilities to its clients on payments and transfers, and showed no actual improvement of its financial position in result of measures undertaken by the National Bank of Kazakhstan under the introduced regime of conservation in “Kazkomir” OJSC within the period from October 11 through December 11, 2001.

**Bank Inspecting.** Fourteen inspections, including 11 complex checks and 3 sampling checks, were carried out in 2001. Inspection of banks during 2001 uncovered the following main shortcomings:

Insufficiency of equity capital;

Inadequate reflection of assets’ quality, and respectively, insufficient provisions and inadequate reflection of bank income;

In many cases one group, in fact, owns a bank;

Actual lending to affiliated persons (share-holders) with considerable violation of a coefficient of maximum risk per borrower.

At present, process of equity capital compilation is not sufficiently transparent in some banks. Another problem, the inspection of assets quality faced, was insufficiency of collateral and practice of lending to the financially unstable entities.

To increase the efficiency of bank inspections further legal improvement of inspecting practice will be continued in the coming year.

**Audit of banks.** As of January 1, 2002 twenty three audit organizations (18 Kazakhstani and 5 international audit organizations) and 41 auditors have bank auditing license of the National Bank of Kazakhstan.

In 2000, the international audit organizations audited 37 banks (the summarized assets account for 95,4% of total banking system assets). Information on contracts made by the banks for auditing services for 2001, the international audit organizations would check, by the end of 2001, 34 banks or 98,9% of consolidated assets of banking sector.

In 2001, eleven entities applied for a license on banking audit (4 audit organizations and 7 auditors). The carried out review sessions made decisions to issue licenses to 4 audit organizations and 4 independent auditors.

**Sector of organizations implementing some banking operations.** Non-banking organizations deliver a variety of banking services to the wide groups of population, including poor people, individual entrepreneurs, agricultural producers and other, serving the needs of the latter in crediting, first of all, including graceful lending (credit partnerships, pawn-shops, entities engaged in lending operations and financial leasing). Non-banking institutions

provide also specialized banking services (receipt of individual and corporate deposits – “Kazpost” OJSC, clearing operations – “Financial Industrial Company “Timei” OJSC).

**General information.** As of January 1, 2002 there were 97 non-banking organizations in total (101 as of January 1, 2001), including 19 credit partnerships, 45 pawn-shops, and 33 organizations carrying out some banking operations. In above, 51 branches of non-banking organizations and 155 pawn-shop reception outlets were functioning by early 2002.

Out of 97 non-banking organizations 24 were the legal entities with state stake. This is due to a need to conduct state policy in the area of small and medium business development and carry out social programs to support poor.

After the Government of Republic of Kazakhstan adopted a Decree “On crediting agrarian sector” on January 25, 2001, №137, creation of rural credit partnerships evolved actively in the indicated period. 11 rural credit partnerships were established during 2001.

Non-banking organizations are represented in all regions of the country, however, concentration of such organizations varies significantly depending on region. This is due to the economic conditions, including existing demand for their services and availability of profitable projects for financing. For example, a number of non-banking organizations located in Almaty city and Almaty oblast accounts for 36 or 37% of total number, in Astana and Akmola oblast - 26 or 26,8%.

**Consolidated equity capital of non-banking organizations** was 8,3 bln. Tenge worth on January 1, 2002, having risen by 2,7 bln. Tenge or by 32,8% within the year. Main reason for such growth was an increase of paid-up authorized capital by 1,2 bln. Tenge during 2001. The outcome of 2001 showed profitability of the equity capital at 8,5% against 9,8% for 2000.

**Consolidated assets of non-banking organizations** declined by 1,6 bln. Tenge during 2001 and amounted to 74,8 bln. Tenge. Cash part of assets (including bank accounts) decreased by 2,9 bln. Tenge and corporate participation in capital reduced by 1,1 bln. Tenge. Simultaneously, fixed assets rose by 1,3 bln. Tenge and long-term investment increased by 1,0 bln. Tenge.

In 2001, the National Bank of Kazakhstan granted licenses to 7 organizations engaged in some banking, 6 pawn-shops and 13 credit partnerships. License of 1 pawn-shop and permission to open 1 pawn-shop were revoked for a reason of violation of existing banking legislation. Licenses for banking and other operations were revoked from 1 pawn-shop, 3 credit partnerships and 1 organization engaged in some banking based on their application to terminate their activity voluntarily.

While supervising the non-banking organizations, violations of existing banking legislation were uncovered. In order to eliminate these violations the limit scope measures pursuant existing legislation were applied to the non-banking organizations in 20 cases, including written warnings, prescriptions and demand of commitment letters.

## **5.2. Insurance sector**

2001 saw high growth rates of insurance market development. Considerable rise of insurance premiums and payments on voluntary insurance was a distinguishing feature. A share of obligatory insurance went up insignificantly. These trends evolved given significant growth of insurance companies’ capitalization.

Total **volume of insurance premiums** increased in 2001 by 70,1% and achieved 13,9 bln. Tenge (0,4% of GDP). Given this, an average insurance premium per capita was about 927 Tenge (in 2000 – 543,7 Tenge) (Annex 5).

Consolidated **volume of insurance payments** went up by 96,2% up to 2,2 bln. Tenge. An average insurance payment per capita for 2001 was about 147 Tenge (in 2000 – 74,7 Tenge).

Insurance premiums in the amount of 9,5 bln. Tenge (in 2000 – 5,6 bln. Tenge) were transferred on re-insurance operations, of which 9,2 bln. Tenge (in 2000 – 5,5 bln. Tenge) or about 96,8% were transferred abroad.

38 insurance companies including 2 – with state participation, 5 – with foreign participation, and 1 – on life insurance hold insurance licenses in Kazakhstan as of January 1, 2002. Most head offices of insurance companies are located in Almaty (27 insurance companies). A branch network of the insurance organizations ensures accessibility of insurance services. There were 280 branches and representations of insurance companies in the republic by the end of the year.

In 2001 summarized paid-up authorized capital of insurance companies increased by 8,4% and amounted to about 4,1 bln. Tenge. Authorized capital of insurance companies was compiled exclusively by cash. As of January 1, 2002 *consolidated equity capital* of insurance companies was 5,3 bln. Tenge, having been increased by 15,2% within the year. Total volume of insurance reserves hiked 3,8 times and achieved 8,6 bln. Tenge.

Considerable growth of the insurance premiums promoted enlargement of *assets* of insurance organizations, which rose 88,9% in 2001 and amounted to 15,8 bln. Tenge. Given this, quality and liquidity of insurance companies' assets were improving substantially, and financial sustainability and reliability of their liabilities' execution increased. Highly liquid assets (assets on deposits and in custody of second-tier banks) upsurged 1,9 times and amounted to 4,6 bln. Tenge, of which current discount value of the insurance companies' assets in custody of second-tier banks in the form of government securities was 1,7 bln. Tenge worth.

Structure of insurance premiums, insurance payments, assets of insurance companies in second-tier banks and comparative data on insurance market for the last 5 years are given in the Annex 5.

In 2001, 3 licenses were granted to insurance brokers, 15 – to insurance market actuaries and 21 – to auditors authorized to audit insurance companies.

Improvement of insurance legislation, regulatory methods and building-up of new infrastructure of insurance market enabled to enhance considerably the level of its professional operators, financial sustainability and creditworthiness of insurance companies as well as increase trust to this segment of financial market from the insured people. Regulation and supervision over insurance activities is carried out in compliance with the main principles and standards of the International Association of Insurance Supervisions Bodies (IAIS).

The National Bank of Kazakhstan made 15 checks of the insurance organizations in 2001.

In 2001, the National Bank of Kazakhstan adopted and registered with the Ministry of Justice 18 regulatory acts on insurance and insurance supervision, including rules on consolidated supervision over insurance (re-insurance) organizations, manner of reconciliation candidatures for management of the insurance (re-insurance) organizations. Strict requirements on implementing re-insurance operations in foreign re-insurance organizations (availability of respective ratings from international rating agencies) were established, and methodology to calculate equity capital including quality assessment and assets liquidity was defined. Restrictions for the founders originating from off-shore zones were introduced. Minimal authorized capital for insurance brokers in the amount of 10 mln. Tenge was established. Technical requirements on manufacturing insurance policies on mass insurance types were defined.

Currently, insurance market of the republic is considerably adapted to the participation in the international modalities of insurance and re-insurance.

In 2001, Kazakhstani Actuary Center was established. It will provide methodological base for actuary activities in the market of insurance and pension services, enable to create a

necessary basis for statistical and any other information in all areas of insurance, including – social sphere. The Laws on obligatory insurance of civil and legal responsibility of vehicle owners and carriers to passengers were drafted and passed to the Parliament of the Republic of Kazakhstan for review.

According to the plan of implementing the State program on insurance development in Kazakhstan for 2000-2002, the issues of proposal drafting and adoption of government measures to solve many important problems of insurance market, and obligatory insurance, in first turn, in the production and entrepreneurship activities, are within the competence of other republican bodies.

The work on practicing insurance principles in the area of pensions services (through introduction of pensions annuities) as well as other social spheres including mandatory social and medical insurance was initiated jointly with the Ministry of Labor and social protection and Health Ministry of the Republic of Kazakhstan.

### **5.3. Securities Market Operators**

In July 2001 the National Bank of Kazakhstan incurred the functions and powers of the National Commission on Securities to enhance efficiency of state regulation and carry out measures to develop a single government agency to regulate financial market.

Department on securities market regulation was established in the structure of the National Bank of Kazakhstan. Accordingly, the National Bank of Kazakhstan currently regulates and supervises activities of securities market operators, issuance of respective licenses and permissions, carries out state registration of securities issues, assign national identification numbers to the securities, and implements other functions, carried out previously by the National Commission on Securities of the Republic of Kazakhstan.

Brokers-dealers, registrars, custodians, pension assets managing companies, companies managing securities portfolio as well as self-regulated professional operators of the securities market form an institutional structure of securities market.

**Brokers-dealers.** A hike of interest to the market of non-government securities was a major event of 2001, having been reflected by an occurrence of new brokers-dealers-non-banking organizations. In total, 7 brokerage and dealing licenses were issued within 2001. Accounting for the revoked and terminated licenses, a total number of brokerage companies rose from 26 to 28. In parallel, development of brokers - dealers - non-banking organizations as underwriters and financial consultants during issuance of non-government securities continues further. Thus, in 2001 Kazakhstani brokerage companies (“TuranAlem Securities” LLP, “Kazkommertz Securities” OJSC) made their debut as co-managers in placing Euronotes of Subsidiary “TuranAlem Finance B.V.” and Euronotes of CJSC “National oil transportation company “KazTransOil”. Brokers - dealers - non-banking organizations took also part in carrying out 5 issuance of municipal obligations and 11 emissions of non-government obligations. A number of brokers-dealers–banks declined by 2 (down to 23) within 2001. As of January 1, 2002, 51 brokers-dealers operated in Kazakhstan.

**Registrars.** As of January 1, 2002 there are 21 independent registrars in Kazakhstan. Total number of the issuers served by registrars was 2548 as of October 1, 2001. The registrars remain distributed unevenly throughout the country’s territory. Head offices of 12 registrars were located in Almaty as of October 1, 2001.

**Pension assets managing companies.** As of January 1, 2002 seven companies managing pensions assets of non-government pension funds as well as State accumulation pension fund, managing its pension assets independently, hold respective licenses. Policy addressing expansion of investment opportunities accounting for the main principles of accumulative pension system of the Republic of Kazakhstan – to preserve pension accumulations of citizens and minimize risks while investing, was continued.

***Self-regulated professional operators of securities market.*** Legislation of the Republic of Kazakhstan provides for two forms of self-regulated organizations: association of professional market operators and stock exchange. A number of self-regulated organizations did not change during 2001. It includes stock exchange and 2 associations of professional securities market operators (Kazakhstani association of roster-holders and Association of Asset Managers).

Other entities of institutional infrastructure showed no substantial changes in their quantitative indicators in 2001, and as January 1, 2002, 11 custodians and 3 managers of securities portfolio were functioning in Kazakhstan (Annex 6). For a number of social, economic and regulatory reasons, investment fund as a form of collective investment remains undeveloped in Kazakhstan. No investment fund was registered as of January 1, 2002.

***State registration of securities issues, assignment of national identification numbers to the national securities, etc.*** 100 issues of shares of total nominal value 31,2 bln. Tenge worth were registered in Kazakhstan in 2001, being below similar indicators of 2000 by 53,9% and 37%, respectively. In result, as of January 1, 2002, there were registered 6879 share issues with summarized nominal value 671 bln. Tenge worth.

A share of subsequent share issues in total number of the registered share issues increased considerably (from 69,6% to 88%). Given this, 39,8% of total number of subsequently registered issues was registered by insurance companies, pension assets managing companies, accumulation pension funds, second-tier banks to execute time liabilities in respect of capitalization and compliance with the prudential norms pursuant legislative requirements of the Republic of Kazakhstan.

During 2001, the national identification numbers were assigned to 477 share issues, requiring no state registration, at total nominal value 72,0 bln. Tenge worth, of which closed joint stock companies accounted for 54,3% and 85,8%, respectively. 548 reports on share issues and placements were approved, and 87 share issues of nominal value 8,4 bln. Tenge were nullified. A total number of issues running as of January 1, 2002 (less nullified or recognized as failed) was 3375 (summarized value of 620,4 bln. Tenge), of which 2131 issues (386,0 bln. Tenge) were registered and 1244 issues (234,4 bln. Tenge) required no registration.

17 issues of non-government obligations (in the amount of 28,5 bln. Tenge) were registered, and 7 reports on obligation repayment were approved. 26 issues with total nominal value 47,2 bln. Tenge worth were run as of January 1, 2002. Obligations of 21 issues in the amount of 46,8 bln. Tenge were included in Kazakhstani Stock Exchange listing. 245 government securities including 112 issues of the Ministry's of Finance securities, 128 issues of the National Bank's notes and 5 issues of local government securities got their national identification number assigned.

***Preparation of specialists for securities market.*** Elaboration of a computerized system for testing applicants for the first and second category qualification certificates was an important event for the securities market. This system is to be operated after the Ministry of Justice registers it and the Decree of the National Bank's of Kazakhstan Board "On approving Instruction to carry out qualification attestation of the specialists to work in securities market" dated December 8 2001, № 528 becomes effective.

#### **5.4. Liquidation of Insolvent Banks and Insurance Companies**

***Process of liquidation banks and their branches based on decision of the National Bank of Kazakhstan.*** In 2001, the National Bank of Kazakhstan undertook serious efforts to complete non-judicial liquidation of banks. The measures were worked out to finalize liquidation in 21 banks, and practical assistance was delivered to some regional branches including preparation of liquidation reports. Besides, an interaction with justice bodies and Committee on court administration under Supreme Court of the Republic of Kazakhstan was

active to promote court decision enforcement on debt recovery in favor of banks' liquidation commissions.

As a result, by January 1, 2001 liquidation is completed in 9 banks and 24 branches out of 26 banks and 48 their branches, which are under compulsory (non-judicial) liquidation. Besides, in December 2001, the bank liquidation commissions presented 21 liquidation reports to the National Bank of Kazakhstan.

During 2001 the liquidation commissions made settlements with the creditors of the indicated banks in total amount of 36,7 mln. Tenge. Total liabilities shrunk by 15,2% within the year and by the end of 2001 amounted to 8129,1 mln. Tenge for 17 liquidated banks, of which claims of creditors – individuals on deposits and bank transfers was 0,5%. Accordingly, total assets of liquidated banks decreased by 45,2% within the year and were 2147,4 mln. Tenge worth.

***The activities of the National Bank of Kazakhstan on control over liquidation commissions of the banks and insurance companies liquidated pursuant court decision and voluntarily.*** In 2001, the Laws of the Republic of Kazakhstan “On insurance activity” and “On amendments and additions to some legislation on banking of the Republic of Kazakhstan” empowered the National Bank of Kazakhstan to carry out control over functioning of the liquidation commissions in banks and insurance (re-insurance) organizations, irrespective of liquidation grounds.

To protect the rights and legal interests of banks' and insurance companies' creditors, strengthen population's trust to banking and insurance sectors of the economy, the National Bank of Kazakhstan improved regulatory framework on liquidation procedures and controlling methods over liquidation in banks and insurance (re-insurance) companies, worked out liquidation measures, exercised control over enforcement of the existing legislation by the liquidation commissions, undertook efforts to eliminate problems arising in the liquidation processes, and ensured interaction with the ministries, agencies and government bodies and other concerned parties on the territory of both Republic of Kazakhstan and beyond its borders.

In 2001, operations of liquidation commissions in 15 banks and 2 insurance companies were inspected, enabling to study a real status of liquidation proceedings as of moment the National Bank of Kazakhstan incurred the controlling powers as well as to uncover violations by liquidation commissions. A special attention was paid to enforcement of legislation requirements by liquidation commissions while carrying out primary measures, property realization, settlements with creditors, their financial discipline, etc. In respect of the uncovered violations, written prescriptions on their elimination were distributed, and the courts, which made decision on bank liquidation and supervised liquidation commissions' activities, were informed.

Additional requirements to the regional branches of the National Bank of Kazakhstan on control over the liquidation processes were introduced.

## VI. PAYMENT SYSTEM

Efficient functioning of payment system is important for the National Bank of Kazakhstan to maintain sustainable financial system and conduct successful monetary policy. Sustainability of financial position of each economic operator, timely raised budget revenues, and, accordingly, an overall economic and political stability of state depend on velocity and security of money transfers. Therefore, further improvement of existing payment system in part of its maximum efficiency and reliability is one of the most important objectives of the National Bank of Kazakhstan.

After interbank money transfer system, which carries out payments and money transfer in real time regime, was put in operation in 2000, the Republic of Kazakhstan has gone far ahead of CIS countries in payment system progress. At current stage, the interbank money transfer system meets all main requirements put forward by the world financial institutions (International Monetary Fund, Bank for International Settlements) and is highly appreciated by the international experts.

In overall, 11,1 mln. transactions amounting to 10,3 trillion Tenge were carried via interbank money transfer system and interbank clearing during 2001. 34% of all payments are held via interbank money transfer system accounting for 94% of total value of payments made in payment systems. Due to continuing positive economic growth trends and enhanced trust to payment system, a number and amount of payments in payment systems increased in 2001 by 12% and 45%, respectively, as compared with 2000.

**Interbank money transfer system.** As of January 1, 2002, there were 74 system users including 44 second-tier banks, Treasury Committee of the Ministry of Finance of Kazakhstan and its 16 regional departments, and 11 organizations engaged in some banking.

In 2001, 3735,3 thousand transactions in total amount of 9708,6 bln. Tenge were held through interbank money transfer system. As compared with 2000, a number of payments declined by 42,6%, whereas value of payments hiked 43,5%. Since a system addresses high priority and urgent payments and money transfers, growth of transactions' volume was affected by increased transactions on securities and payments carried out by Treasury Committee of the Ministry of Finance by 48,5% and 29,1%, respectively. Dynamics of payments via interbank money transfer system for the period from 1997 through 2001 is given in Annex 1.

**Interbank clearing.** RSE "Kazakhstani center for interbank settlements of the National Bank of Kazakhstan" and clearing chamber "Financial and industrial company "Timei" LLP carried out interbank clearing in 2001.

As of January 1, 2002, RSE "Kazakhstani center for interbank settlements of the National Bank of Kazakhstan" comprised 53 interbank clearing participants, including 32 second-tier banks, "Kazpost" OJSC, Treasury Committee of the Ministry of Finance of Kazakhstan and its regional departments, and State Center for Pension Payments. Interbank clearing by "Financial and industrial company "Timei" LLP covered 5 second-tier banks (their branches) and Treasury regional department in Northern Kazakhstan.

In 2001, 7314,3 thousand payments were made via interbank clearing having overcome 2,2 times that of 2000. The volume of transactions increased by 87,4% and amounted to 583,5 bln. Tenge, as compared with 2000. In 2001, an average money velocity in the system of interbank clearing was 3,2.

The quantity and amounts of payments increased mostly due to a reduction of processing tariffs per one payment document in the system of interbank clearing and an increased from 56 to 59 number of clearing participants. Due to that system addresses relatively small amount payments, an increase of total number of such sort deals resulted in an upsurge of document turnover and volumes of transactions.

**Payment cards.** The National Bank of Kazakhstan extended licenses on payment card issuance to 19 second-tier banks, of which 14 banks are producing payment cards. The second-tier banks issue local system payment cards: Altyn card – “Halyk Savings Bank of Kazakhstan” OJSC, SmartAlemCard – “Bank TuranAlem” OJSC, cards of “Caspyskiy Bank” OJSC and “Citibank” OJSC, as well as international system cards - Europay International, VISA International, American Express, and Diners Club International.

As of January 1, 2002, Kazakhstani banks issued over 1,2 mln. payment cards, and there were 1,17 mln. card-holders in Kazakhstan. In relative terms, it means that there were 82,2 cards per each thousand people, of which international and local systems cards accounted for 81% and 19%, respectively. By the end of 2000 these ratios were 54% and 46%, respectively. A share of international cards in circulation increased due to that card-holders switched from local systems to the international ones.

“Wage” projects provide a major bulk in structure of payment cards, accounting for 55% of total number of payment cards in circulation as of January 1, 2002.

Total number of payment cards in circulation by systems is given in Table 6.1.

Table 6.1

**Payment cards in circulation**

	As of January 1, 2001		Issued (with-drawn) in 2000	As of January 1, 2002		Issued (with-drawn) in 2001	Change over year in %%	
	Quantity in circulation, thousand pieces	Share of total, %		Quantity in circulation, thousand pieces	Share of total, %		Quantity in circulation	Issued
International	509,3	54%	357,1	987,2	81%	437,8	94%	23%
Of which								
VISA	447,4	47%	332,2	851,6	70%	404,2	90%	22%
Europay	61,8	7%	24,9	124,3	10%	62,4	101%	151%
other	0,1	0,01 %	0,0	11,3	1%	11,2	98 times	1394 times
Local:	440,6	46%	16,7	231,7	19%	-208,8	-47%	-1349%
Of which								
ALTYN	203,4	21%	-4,9	213,6	18%	10,2	5%	307%
other	237,2	25%	21,6	18,2	2%	-219,0	-92%	-1113%
Total:	949,9	100%	373,8	1218,9	100%	267,0	28%	-28%

As of January 1, 2002, 1343 enterprises, which accepted payment cards while selling goods or services were networked in Kazakhstan. 2580 payment terminals and 1789 imprinters were used to service payment cards and 539 ATMs functioned to enable encashment.

Total volume of transactions carried out via payment cards in the serviced networks of the banks in the Republic of Kazakhstan during 2001 was 14,5 mln. payments in the amount of 142,2 bln. Tenge. Out of these transactions, non-cash and cash payments accounted for 3% and 97%, respectively. Kazakhstani card-holders were actively using international system payment cards while staying abroad - 297,3 thousand transactions in the amount of 11,6 bln. Tenge, of which the quantity and amount of non-cash payments accounted for 47% and 34%, respectively. Thus, the card-holders in Kazakhstan, like previously, use payments cards mainly to withdraw cash and rarely to pay for goods or services.

To decrease cash payments and increase non-cash payments, the National Bank of Kazakhstan continued its efforts to develop National interbank system of payment cards. In 2001, negotiations were held with the representatives of VISA Europay international system to arrange transaction processing of international payment cards through “Processing Center”

CJSC. The Requirements to the national interbank system of payment cards was drafted and agreed with second-tier banks.

In above, the National Bank of Kazakhstan jointly with the Ministries of Finance and Transport & Communications of Kazakhstan drafted a Program on National interbank payment microprocessor cards as well as Plan of measures to implement this Program. Main objectives of this Program implementation are the following: to introduce new information technologies in retail payment systems at the state level, accumulate significant finance in banking system of Kazakhstan to enable investment in real sector of economy due to relocation of huge cash masses into account-based flows, strengthen control over money circulation, reduce shadow cash flows, promote programs addressing corruption elimination by the use of the microprocessor cards in government structures to carry out budget (tax, customs) and other obligatory payments via non-cash settlements.

***Other payment instruments.*** Payment orders were main means to make non-cash payments by the second-tier banks in 2001. 14,4 mln. documents in the amount of 11,2 trillion Tenge were processed, accounting for 94,4% and 98,1%, respectively, of total quantity and amount of all payment instruments. Out of other means, enactment orders accounted for 1,5% and 1,4%, payment cards - 2,9% and 0,05%, cheques for paying for goods and services – 0,03% and 0,04%, payment claims-orders - 0,95% and 0,24%, and direct debit of bank account – 0,2% and 0,14%, respectively, of payments and money transfers.

## VII. REGULATORY ACTIVITIES

In 2001, the National Bank of Kazakhstan adopted and enforced 18 regulatory acts on regulation of **insurance activities and insurance supervision**. These legal acts provide for stricter requirements put forward for qualification of managing staff of the insurance organizations and brokers and identify more precisely the conditions for re-insurance including that abroad.

Also, the laws were drafted on mandatory insurance of civil and legal responsibility of vehicle owners and civil-legal responsibility of the carriers to passenger. Adoption of these laws would enable, in particular, to reduce costs of insurance services due to mass scope insurance.

The National Bank of Kazakhstan jointly with other concerned governmental bodies was involved in further reforming of pension and medical services markets (draft Law “On amendments and additions to the Law of the Republic of Kazakhstan “On pensions in Kazakhstan”, which provides for a need to use insurance principles in pension system, and a Concept of medical insurance in the Republic of Kazakhstan).

The National Bank of Kazakhstan formulated more precisely taxation of insurance companies and other operators of insurance market, which grant additional opportunities to expand investment activity of the insurance organizations (draft new Tax Code). The list of mandatory insurance types was identified jointly with other government bodies.

The Law of the Republic of Kazakhstan “On amendments and additions to some legislative acts in area of **foreign exchange** regulation” was effective since February 2, 2001. It strengthens government control over the foreign exchange operations throughout the territory of the Republic of Kazakhstan and in area of foreign economic activities.

The Law of the Republic of Kazakhstan “On Kazakhstan membership in the International Monetary Fund, International Bank for Reconstruction and Development, International Financial Corporation, International Development Association, Multilateral Investment Guarantee Agency, International Center for Settlement of Investment Disputes, European Bank for Reconstruction and Development, Asian Development Bank, and Islamic Development Bank” was adopted on December 6, 2001. The law was drafted by the National Bank of Kazakhstan to unify the legal acts of the Republic of Kazakhstan, which regulate membership of the Republic of Kazakhstan in international financial organizations.

In order to strengthen foreign exchange government control over the export-import transactions carried out by foreign economic operators, the Law “On amendments and additions to some legislative acts of the Republic of Kazakhstan on banking, foreign exchange regulation and control” was drafted.

In particular, in order to avoid purposeful prolongation of the liabilities to return funds in foreign currency funds, the Law of the Republic of Kazakhstan “On licensing” makes definition of one-time license more precise in part of restricting validity of licenses issued by the National Bank of Kazakhstan to carry out capital operations.

To escape a need to license forex capital transactions, amounts of which are small against costs of license award (license fee), a minimal transaction value to be licensed is introduced.

To make securities market of Kazakhstan more active, the existing legislative contradictions were eliminated. These contradictions disabled the authorized banks to be engaged in broker-dealing activities on non-resident securities, which are the most liquid assets.

Pursuant the Plan *of law drafting by Inter-Parliament Committee* of the Republic of Belarus, the Republic of Kazakhstan, Kyrgyz Republic, Russian Federation and Republic of Tajikistan, a model Law “On common principles of forex market organization and functioning” was drafted. This draft Law defines basic principles of operations of the central

(national) banks in the forex markets of respective states and common requirements to the forex market operators.

In area of **banking** regulation, a Law of the Republic of Kazakhstan “On amendments and additions to some legislative acts of the Republic of Kazakhstan on banking” became effective on March 12, 2001. The law aims at employment of consolidated supervision over banking activity to develop legislative conditions for accounting and objective assessment of all risks, the banks are exposed to, as well as control over the liquidation commissions of the banks.

The National Bank of Kazakhstan adopted 6 regulatory acts to implement this Law.

Also, the Laws of the Republic of Kazakhstan “On state regulation and supervision over the financial services” and “On amendments and additions to some legislative acts on organizing a single system of state regulation of financial market and supervising its relations” were drafted. These draft laws provide for that a special authorized government body defined by the President would carry out state regulation and supervision over the financial services.

In area of **regulation of lending to the economy**, a Law of the Republic of Kazakhstan “On amendments and additions to some legislative acts on mortgage crediting” was drafted. Adoption of this Law would ensure more active operations of the market agents, engaged in direct crediting of housing acquisition by people.

A Law of the Republic of Kazakhstan “On microcredit organizations” was drafted. It would build up a framework to introduce simplified procedures to establish and operate microcredit organizations. Adoption of this Law would promote entrepreneurship including that in rural locations, increase competition in the credit market and facilitate well-being of population.

A Law of the Republic of Kazakhstan “On credit partnerships” was drafted. Adoption of this law would promote development of mutual credit sector to meet demand for financial services from low and medium income groups of population and non-commercial organizations.

In area of **securities market regulation**, the Laws “On joint stock companies” and “On amendments and additions to some legislative acts on securities market and joint stock companies” were drafted. Adoption of these laws would allow simplifying share circulation in the secondary securities market, identify more specifically professional operations in the market, and regulate corporate management aspects in joint stock companies.

Besides, the draft Law of the Republic of Kazakhstan “On amendments and additions to some legislative acts on securities market and joint stock companies” sets new definitions of “security”, “obligation” and “share”, makes the principles of confirming stock-holding rights more precise, establishes new norms on statutory documentation for the legal entities (and not for joint stock companies only), eliminates quantitative membership restriction in limited liability partnerships (enabling reduction of a number of organizations forced to function in legal form of joint stock company due to a large number of their participants) and additional norms are introduced to protect the rights of obligation owners.

Legal improvements in legislative infrastructure regulating securities issuance and circulation, activities of stock market operators, as well as determining manner and structure of state regulation of the stock market relations were developed further during 2001.

A new version of the Law of the Republic of Kazakhstan “On securities market” was drafted. This draft law improves the norms regulating securities issuance, circulation and repayment, registration of deals on securities, creation and operations of the market professional participants and organizations, which form stock market infrastructure, legal status and competence of the authorized regulatory body.

Besides, the Decree of the Directorate of the National Securities Commission “On audit reports to be submitted by the organizations holding license to function in the securities market” dated May 14, 2001, № 825 (registered with the Ministry of Justice of the Republic of Kazakhstan on June 29, 2001, № 1560) obliges, starting January 1, 2002, all organizations, which hold duly authorized license to operate in the stock market, to submit annually the audit reports attached to their annual financial statement for the latest completed fiscal year to the authorized body.

To implement the Law of the Republic of Kazakhstan “On amnesty of citizens of the Republic of Kazakhstan due to money legalization” and carry out the action of legalizing money by Kazakhstani citizens, a number of legislative acts were worked out, which **regulated a manner of opening and maintaining special accounts on money legalization.**

In above, in order to develop **payment systems** in the Republic of Kazakhstan, there were worked out the regulatory acts, which govern licensing and operating of clearing organizations as well as inspecting by the National Bank of Kazakhstan, and which regulate payment card system improving and payment system monitoring in the Republic of Kazakhstan.

Legal acts to regulate circulation of the securities issued by the National Bank of Kazakhstan as well as rules to determine realized income and expenditures on foreign currency, precious metals and golden refined coins transactions based on their average weighted value, were elaborated.

To **improve accounting** of the National Bank of Kazakhstan, second-tier banks and insurance companies, a series of legislative and regulatory acts was worked out: accounting standards № 21 “Financial statement of the banks” and “ On approval of the accounting provisions (standard) № 30 “Accounting and reporting of insurance organization”, and Detailed Plan of accounts to compile Main Ledges of the second-tier banks.

The regulatory acts, which define requirements to bill paper produced in Kazakhstan or imported, licensing of stamped paper production, circulation of cash “Euro” as well as accounting for gold and foreign exchange assets of the National Bank of Kazakhstan externally managed by foreign banks and specialized companies, were worked out.

In 2001, an authorized body continued its policy to expand **investment opportunities of the Pension Assets Managing Companies (PAMC)**. A number of Decrees was adopted to implement this policy.

To build up regulatory framework in part of **bank and insurance (re-insurance) companies liquidation**, the National Bank of Kazakhstan worked out 8 regulatory acts, which govern activities of liquidation commissions and powers of creditors’ committee, defines a manner of checks and control over liquidation commissions, reporting by the liquidation commissions, credit roster and other issues. Out of these acts, 3 were registered with justice bodies. Besides, the National Bank of Kazakhstan initiated clauses in the new Tax Code, which exempt the liquidation commissions of the compulsorily liquidated banks of levying state duty when applying to courts to recover debts and admit the debtors bankrupts.

The proposals to amend the existing legislation were worked out and made. These proposals include the norms regulating the cases, when the National Bank of Kazakhstan finances some costs on the compulsory liquidation of bank and insurance (re-insurance) companies given these entities lack funds. The norms provide for administrative responsibility of liquidation commission chairmen, and enactment of a single manner to prepare and license the activities of liquidation commission chairmen of the banks and insurance (re-insurance) companies liquidated in compulsory manner.

## **VIII. INTERNATIONAL COOPERATION AND PUBLIC RELATIONS**

In 2001, the National Bank of Kazakhstan continued to service and realize the loans extended to Kazakhstan by the international financial organizations.

The work on twinning agreements with the second-tier banks was carried out and training program for the employees of the National Bank of Kazakhstan was implemented. A review of payment system of Kazakhstan financed by loan from Epaycom company was made, and a survey of 100 largest borrowers financed by “Arthur Andersen” was carried out. The interest and commissions for the loans LN3867 KZ and LN3642KZ and principal were paid out.

Due to that in July 2001 the Government of Kazakhstan made a decision to nullify an unused part of IBRD loan LN3867 KZ (including part of the National Bank’s of Kazakhstan amount), the works to complete loan implementation and loan-financed contracts were carried out.

EBRD credit line to the second-tier banks was proceeded, namely, the agreements made by “Kazkommertzbank” OJSC for the A tranche funds (Projects “Interhotel”) were monitored.

In 2001, cooperation with governments and central banks of CIS countries was developed further. The debt liabilities were reconciled between the Republic of Kazakhstan and CIS countries. There were signed the Minutes on amendments brought into Agreement between the Republic of Kazakhstan, Kyrgyz Republic, Republic of Tajikistan and Republic of Uzbekistan to found Central Asian Bank for cooperation and development on July 8, 1994 (January 5, 2001), an Agreement on Council of national (central) banks’ governors of the member-states of Treaty on Eurasian Economic community on October 10, 2000 (February 15, 2001), and an Agreement on information, analytical and consultative collaboration between the central (national) banks of the member-states of Treaty on Eurasian Economic community (November 14, 2001).

In November 2001, the events were held devoted to 10<sup>th</sup> anniversary of the Republic of Kazakhstan and 10-th anniversary of the National Bank of Kazakhstan, which involved governors of CIS central banks, managers of financial organizations, second-tier banks, insurance companies, pension funds and representations of foreign companies in Kazakhstan.

The representatives of the National Bank of Kazakhstan participated in bilateral inter-governmental commissions on economic cooperation (with Azerbaijan, Latvia, Tajikistan and Uzbekistan) to regulate arrears produced by settlements during 1992-1993, as well as with Turkey, Pakistan, Japan, Egypt, Poland, Romania, Qatar, Slovakia – on cooperation in financial and banking sphere.

Public relations development included further building of an open image of the National Bank of Kazakhstan. Over 300 public reports in mass-media were made including 51 programs on Kazakh TV, 16 press-conferences, and 16 PR-actions (on insurance and mortgage companies, second-tier banks, Universities, Open Door days, and public discussions held by management of the National Bank of Kazakhstan on “Khabar” TV). Since November a special column in “Kazakhstanskaya pravda” newspaper titled “The National Bank of Kazakhstan comments, explains and answers” is published monthly.

## IX. ACCOUNTING AND FINANCIAL STATEMENT IMPROVEMENT

In 2001, within the framework of Kazakhstani *banking system* transition to international standards on financial statement, an accounting satandard №21 “Bank financial statement”, brought up to the international standards, was approved. To approach assets market value more adequately pursuant market value concept accepted in the international standards on financial statement, the instructions were given to the second-tier banks to use average weighted market rate of Tenge vis-à-vis foreign currencies while reporting the National Bank of Kazakhstan.

To implement money legalization action, the National Bank of Kazakhstan participated in elaboration of the Instruction for the second-tier banks on opening and maintaining special accounts of Kazakhstani citizens, amnestied due to legalization of their money. In particular, an instruction on how special accounts’ funds are to be reflected in accounting book-records was prepared and appropriate changes were put into Plan of accounts of the second-tier banks for their Main Ledgers.

Within the framework of the Methodology Council of the Ministry of Finance of Kazakhstan on accounting and audit, during 2001 the National Bank of Kazakhstan was involved in drafting Law of the Republic of Kazakhstan “On the amendments and additions to Edict of the President of the Republic of Kazakhstan, having force of Law “On accounting” in part of accounting and financial statements in banks, organizations engaged in some banking, and insurance (re-insurance) companies. Also, the drafts “Conceptual basis for preparing and submitting financial statements” and Kazakhstani accounting standard “Financial reporting”, brought up to international standards, were reviewed.

During 2000, the working groups checked the transition by second-tier banks to the international standards on financial statement, Based on the results, the National Bank of Kazakhstan extended deadline for transition to the international standards, and prepared and distributed to the banks prescriptions and explanatory letters on the issues related to the certification of Automated bank information system, Main Ledger and auxiliary accounting books. During 2001, distance control and analysis was carried out based on reports of the second-tier banks on their transition to the international financial reporting standards. To identify such transition status, the Coordination Committee on auxiliary accounting conversion and Ledger maintenance on the Plans of accounts in the second-tier banks listened to the reports of the largest banks, the appropriate guiding directions on of banks’ deficiencies and recommendations on their remedy were prepared. Besides, implementation of transition to the international standards of some commercial banks was checked during 2001.

To bring the regulations on financial reporting by the second-tier banks to the international standards, the changes and additions to the Rules on compiling consolidated financial statement by the second-tier banks were worked out.

There were prepared and distributed to the second-tier banks the recommendations on recording pledged property, moved into banks’ ownership, on accounting record procedures, storing and destroying the used bank cheques of the second-tier banks, on reflecting excessive and deficient tyins because of their withdrawal of circulation, on re-converting authorized capital, which nominal value is denominated in foreign currency, on the accounting records replacing national currencies of European Economic and Foreign Exchange Union members for Euro as well as reflecting REPO and back REPO transactions in accounting records pursuant the international standards on financial statement.

*Accounting system in the National Bank of Kazakhstan* was oriented at its further development and approach to the international standards of financial statements during 2001. In this relation, the elaborated and accepted in 2001 accounting policy was based on the requirements of the international standards and recommendations of external auditor. Accounting system employs assets classification, which is defined by National Bank’s of Kazakhstan accounting policy compliant with the international standard № 39 “Financial

instruments: admission and estimate”, and an essence principle regarding fixed assets and intangible assets. The financial assets are recorded in accounting based on an average weighted market rate and securities – at their fair value.

The accounting procedures of the operations of the National Bank of Kazakhstan were described in the regulatory acts of the National Bank of Kazakhstan. In particular, accounting procedures on accounting for the realized and unrealized income/expenses, for operations on Letters of Credit, for authorized and reserve capital and revaluation accounts, for recovery of the receivable accounts, for improvement of book-records on goods and tangibles (stocks), fixed and intangible assets, payable and receivable accounts as well as Plans of accounts of the National Bank of Kazakhstan. Among the measures carried out in 2001, an improved description of the procedures to evaluate and write-off the property of the National Bank of Kazakhstan needs to be noted.

The Board of the National Bank of Kazakhstan approved the forms of financial statement, which were worked out in compliance with the requirements of the international standards on financial statement and recommendations of external auditor.

To increase efficiency of transition to the international financial statement standards, qualification of staff, involved in auxiliary accounting in the branches of the National Bank of Kazakhstan, was improved.

## X. SERVICES DELIVERED TO FINANCIAL INSTITUTIONS

**Asset management of the National Bank of Kazakhstan.** Beginning from May 18, 2001 the first amounts began arriving on the account of the National Fund of the Republic of Kazakhstan. Pursuant the Edict of the President of the Republic of Kazakhstan №402 dated August 23, 2000 and Trust Management Agreement on the National Fund of the Republic of Kazakhstan №299 dated June 11, 2001, the National Bank of Kazakhstan manages the National Fund of the Republic of Kazakhstan. In June, the National Bank of Kazakhstan worked out an investment strategy for the National Fund of the Republic of Kazakhstan, which was approved by the Kazakhstani Government Decree. The strategy defines a general manner, in which the National Bank of Kazakhstan should carry out investment, manage risks, arising in the course of management, select standard portfolio, it identifies timing and content of the National Bank's of Kazakhstan reporting to the Government of Kazakhstan on managing the National Fund of the Republic of Kazakhstan.

In June 2001, USD674,4 mln. were allocated to the National Fund's account on matured deposit, made by the Ministry of Finance on behalf of the National Fund in the National Bank of Kazakhstan. After this deposit, the National Bank of Kazakhstan launched active management of the National Fund's portfolio.

Total market value of foreign currency portfolio of the National Fund was USD1240,4 mln. as of December 31, 2001. As of this date, all Fund's assets formed a stabilization portfolio, the market value of which should account for not less than 20% of market value of all assets. The operations the National Bank of Kazakhstan held on the Fund's assets during the reporting period included 65 purchases and 34 sales of the securities.

In 2001, the National Bank of Kazakhstan invested the National Fund's assets in money market instruments, in particular, in US government bonds, which accounted for 27,84% of total Fund's portfolio as of December 31, 2001. The securities of the US agencies made the largest portion of portfolio amounting to 71,44%. A share of one-day deposits pledged by securities in the foreign banks through the US Federal Reserve System was small and as of December 31, 2001 amounted to 0,72% of total portfolio of the National Fund of Kazakhstan. Structure of assets is shown in Table 10.1.

Table 10.1

**Dynamics of foreign currency assets of the National Fund  
of the Republic of Kazakhstan**

Instruments	As of June 30, 2001	As of September 30, 2001	As of December 31, 2001
Securities	93,67%	98,21%	99,28%
Including			
US government bonds	16,56%	11,88%	27,84%
IFO	9,99%	9,56%	0,00%
Agencies' bonds	67,11%	76,76%	71,44%
Deposits	6,26%	1,79%	0,72%
Current account	0,07%	0,00%	0,00%
Total	100%	100%	100%

**Yields and risks.** The yields of stabilization portfolio during period from June 1 through December 31, 2001 was 2,86% or 4,87% annualized (yields of standard portfolio Salomon 6-month US Treasury Bill Index within similar period was 2,13% or 3,66% annualized). Higher than standard yields of stabilization portfolio were achieved in result of duration management. During the period the National Bank of Kazakhstan increased duration up to 0,67 and lowered down to 0,44 depending on expected changes of short-term interest rates. As the Rules on the National Fund's investment operations require, the duration of Fund's stabilization portfolio should not exceed 0,75. An increase of yields was considerably affected by that changes of ratios in the structure of securities portfolio were managed, and a sector of 6 to 12 month maturity was selected. The yields in this sector benefited within the

period the securities were held, exceeded those on deposits and securities, which mature up to 6 months.

Total income for 2001 (from May 18 through December 31) in foreign currency was USD30,96 mln. worth.

**External management of the National Fund's assets.** Pursuant the Rules, market value of the National Fund's assets transferred to one external manager, should not exceed USD150 mln. In this relation, the National Bank of Kazakhstan carried out a tender to select external managers by mandate types of Global Fixed Income and Global Equities. 16 companies participated in tender of Global Fixed Income mandate and offers from 8 companies were reviewed for Global Equities mandate. A relatively small number of tender participants was due to high requirements put forward by the National Bank of Kazakhstan for the potential bidders. While selecting the external managers, the volume of managed assets both in general and by each mandate separately, experience and professionalism of portfolio managers and analysts, sustainable financial position, and results of managing these very mandate types during the last 5 years were the most important criteria. As a result, 6 external managers were selected: 3 external managers for Global Fixed Income mandate (Deutsche Asset Management, State Street Global Advisors, BNP Paribas Asset Management/FFTW), and 3 external managers – for Global Equities mandate (Morgan Stanley Investment Management, HSBC Asset Management, Credit Suisse Asset Management). On December 28, 2001, the National Bank of Kazakhstan signed the agreements on managing the assets of the National Fund with all selected external managers.

**Selection of custodian for the National Fund of the Republic of Kazakhstan.** At present, the National Bank of Kazakhstan works with one global custodian, having signed an agreement in the end of 2001. Objective reasons for such decision included a lack of sufficient experience in accounting and calculation of investment in shares at that stage, maintenance of respective tax settlements (pursuant standard portfolio it was investment in securities of 21 countries was supposed), an advantage of getting consolidated reports, and a uniform approach in accounting all securities in the portfolio. Based on the offered bids the National Bank of Kazakhstan selected global custodian. Quality of main custodian services as well as quality of range of additional services and their costs were important criteria in selection of custodian. After all bids were studied, a company ABN AMRO Mellon Global Securities Services was selected as a global custodian of the National Fund of the Republic of Kazakhstan. ABN AMRO Mellon company offers its clients a full range of the required services (core & Value Added) in one package. Costs of its services were the most competitive.

**Custodian services and other services on trust management.** In 2001, the National Bank of Kazakhstan continued to deliver *services to "State accumulative pension fund" CJSC* pursuant custodian agreement №148 made on February 1, 1999. During 2001, 175,1 bln. Tenge were allocated to the custodial account of "State accumulative pension fund" CJSC, of which obligatory pension installments accounted to 8,9%, transfers from other non-government pension funds - 0,1%, and returns on investment – 91%. 173,1 bln. Tenge worth were written-down from the custodial account of "State accumulative pension fund" CJSC, out of which the layouts of pension savings accounted for 0,7%, pension savings transfers to private pension funds - 3,8%, and investment – 95,5%.

In 2001, the Banking service bureau finalized previously used prototype of automated information sub-system "Bank-custodian" and, as a result, all investment of the "State accumulative pension fund" CJSC were made using this software.

**Trust servicing of "Kazakhstani individuals' deposit insurance fund" CJSC.** In 2001, the National Bank of Kazakhstan continued trust servicing of "Kazakhstani individuals' deposit insurance fund" CJSC pursuant the made agreement on money trust management.

The amounts got in trust management in 2001 were 963,1 mln. Tenge worth. The funds of “Kazakhstani individuals’ deposit insurance fund” CJSC accepted in trust management were invested in government securities issued by the Government of the Republic of Kazakhstan and the National Bank of Kazakhstan.

Total amounts withdrawn out of trust management in 2001 were 40,72 mln. Tenge worth.

***Trust servicing of “Kazakhstani mortgage company” CJSC.*** In 2001, the National Bank of Kazakhstan, pursuant money trust management agreement, began delivering services to “Kazakhstani mortgage company” CJSC.

The amounts got in 2001 in trust management were 1,5 bln. Tenge worth. The funds of “Kazakhstani mortgage company” CJSC accepted in trust management were invested in government securities issued by the Government of the Republic of Kazakhstan and the National Bank of Kazakhstan

Total amounts withdrawn out of trust management in 2001 were 574,9 mln. Tenge worth.

***Trust servicing of “Processing Center” CJSC.*** Also, in 2001, the National Bank of Kazakhstan, pursuant money trust management agreement, began delivering services to “Processing Center” CJSC. In 2001, the amounts got in trust management from “Processing Center” CJSC were 977,65 mln. Tenge worth, which were invested in government securities issued by the Government of the Republic of Kazakhstan and the National Bank of Kazakhstan.

Total amounts withdrawn out of trust management in 2001 were 3,18 mln. Tenge worth.

***Broker servicing of “Development Bank of Kazakhstan” CJSC.*** Pursuant the agreement on broker servicing, the National Bank of Kazakhstan started delivering services on brokerage and custody of securities, acquired by “Development Bank of Kazakhstan” CJSC. As of January 1, 2002, the value of securities portfolio held by “Development Bank of Kazakhstan” CJSC was 18,6 bln. Tenge worth.

## **XI. ORGANIZATION AND INTERNAL ACTIVITIES**

### **11.1. Organizational Structure**

Structure and total staff (4000 units) of the National Bank of Kazakhstan are approved by the Edict of the President of the Republic of Kazakhstan on August 11, 1999, № 188 “On approving Statement of provisions and structure of the National Bank of Kazakhstan”.

Organizational structure of the National Bank of Kazakhstan includes central headquarters, 16 regional branches, two branches in Almaty city (Banknote factory and Cash operations and valuable storage unit), and Representation of the National Bank of Kazakhstan in Russian Federation. 9 departments, 11 independent divisions and 1 independent sub-division are functioning in the headquarters’ structure of the National Bank of Kazakhstan (Annex 7).

The organizational structure of the National Bank of Kazakhstan saw the following changes during 2001:

1) due to that the National Bank of Kazakhstan incurred the functions and powers of the National Securities Commission of Kazakhstan the following took place in headquarters’ structure:

department on securities regulation was established;

new sub-divisions were introduced in the departments on accounting and information technology, and divisions on logistics, documentation support and control, as well as new division was established in legal department;

2) branches of the National Bank of Kazakhstan in Almaty and Akmola oblasts were established.

The National Bank of Kazakhstan has 4 subordinated organizations (economically independent Republican State Enterprises “Kazakhstani center for interbank settlements”, “Banking service bureau”, “Kazakhstani Mint” and “Motor transport depot of the National Bank of Kazakhstan”), and is a stakeholder of the following subsidiaries: “National Information Technologies” CJSC (a share of the National Bank of Kazakhstan in its authorized capital is 71,8%), which was established in 2001 through a merge with “Center for interbank and financial telecommunications” CJSC; and “Kazakhstani individuals’ deposit insurance fund” CJSC, which was established in November 1999. In December 2000, the National Bank of Kazakhstan founded the close joint stock companies “Processing Center” and “Kazakhstani mortgage company”.

### **11.2. Human Resource Policy and Staff Training**

As of December 31, 2001 the staff number in the National Bank of Kazakhstan including branches and subsidiaries was 3641 (actual - 3472), of which 1083 (956) in headquarters, 1950 (1916) - in branches, and 608 (600) – in subsidiaries (Annex 8).

By the end of 2001, the headquarters was staffed at 87,5%, the regional branches and Cash operations and valuable storage unit– 97,7%, Banknote factory – 91,1%, and the subsidiaries – 98,7%. As of December 31, 2001 staff number enlarged by 166 against December 31, 2000, including an increase by 146 in the headquarters and by 33 – in branches. The staff number in subsidiaries declined by 13.

The employees holding graduate degree account for 76,9% in headquarters, 48,4% - in branches, and 42,6% - in subsidiaries. There are 10,0%, 24% and 18,5% of employees having intermediate college-level technical education in headquarters, branches and subsidiaries, respectively. The employees school graduates account for 13,1%, 27,6% and 38,8% in headquarters, branches and subsidiaries, respectively.

In comparison to 2000, in 2001 a number of government employees rose by 23% due to the established Department on securities regulation in headquarters as well as creation of regional branches in Almaty and Akmola oblasts.

In 2001, 175, 256 and 68 employees resigned from headquarters, branches and subsidiaries, respectively. 255, 260 and 90 staff-members were recruited in headquarters, branches and subsidiaries, respectively. The National Bank of Kazakhstan advertised 4 tenders for vacant government administrative positions. 843 applications were received, 806 candidates were selected for testing, 641 persons were short-listed, and 100 persons won the competition and were recruited. 43 people were taken on staff reserve of the Agency on civil service of the Republic of Kazakhstan.

Also, 4 attestations of administrative government employees of the National Bank of Kazakhstan were held in 2001. The attestation comprised 39 employees. Out of total number of employees attested, 37 are found adequate for their positions, 1 person was subject to undergo attestation once more and 1 person was found inadequate to the position.

In 2001, 844, 864 and 95 specialists were trained in headquarters, branches and other organizations, respectively. Specialists of the National Bank of Kazakhstan, who received training in 2001, accounted for 82,8% of total average staff of the National Bank of Kazakhstan. 1629 employees were trained in the Republic of Kazakhstan. Out of them, 857 people including the specialists of other organizations were trained in the facilities of the National Bank of Kazakhstan, 84 persons were trained in training centers, and 62 and 626 employees got training on English and Kazakh language courses, respectively.

The National Bank of Kazakhstan worked with its personnel reserve in 2001. As of December 30, 2001 there were 109 persons listed in personnel reserve. During 2001, out of reserve personnel 30 employees resigned, 30 persons were promoted, and 13 were downgraded in their positions. Position downgrading was due to restructuring of the headquarters of the National Bank of Kazakhstan and optimization of its management structure carried out in 2001. Also, the efforts were undertaken to adapt newly recruited employees.

**Wages and social layouts.** In 2001, the actually paid wages including social tax and social layouts were 3234,4 mln. Tenge worth, of which 2494,0 mln. Tenge or 96,8% of approved budget were paid in structural units financed by the budget of the National Bank of Kazakhstan, 245,7 mln. Tenge (99,1%) – in Banknote factory, and 494,7 mln. Tenge (96,7%) - in subsidiaries of the National Bank of Kazakhstan.

A share of wages, actually paid to the employees of the structural units financed by the National Bank's budget, accounted for 10,7% (in 2000 – 6,6%) in total expenditures incurred by the NBK, and 40,9% (in 2000 – 11,7%) - in non-monetary expenditures.

The share of wages in total expenditures of independent organizations of the National Bank of Kazakhstan was as follows:

Banknote factory – 13,8% (in 2000 – 11,5%);

RSE “Kazakhstani Center for interbank settlements” – 19,7% (17,2%);

RSE “Banking service bureau” – 62,6% (60,7%);

RSE “Kazakhstani Mint” – 25,3% (26,3%);

RSE “Motor transport depot” – 36,5% (54,1%).

High expenditures in RSE “Banking service bureau” were due to high labor costs of software specialists.

Average monthly wage per employee, which includes allocations on ten-percent obligatory pension installments and taxes, within the system of the National Bank of Kazakhstan was 60161 Tenge worth in 2001, of which that in the structural units financed by

budget of the National Bank of Kazakhstan was 62794 Tenge, that in Banknote factory - 50272 Tenge, and that in National Bank's subsidiaries- 54622 Tenge.

### **11.3. Information Technology Development**

***Design and research works.*** Design and research works addressed further development of information systems of the National Bank of Kazakhstan. In 2001, the planned works to elaborate and operate the computerized information systems were carried out on 42 projects, of which 22 were completed in the last year.

Design and research works carried in 2001 were focused on the following main areas:

Development of sub-system "Data collection and processing for the balance of payments";

Elaboration and operation of information and analytical sub-system "Monitoring of real sector enterprises";

Development and employment of sub-system "Insurance supervision";

Development and operation of sub-system NRA "Lawyer";

Development and introduction of "Electronic documentation flows" in headquarters;

Elaboration of sub-system "Collection and analysis of results of export-import foreign exchange control";

Development of sub-system "Collection and processing of reporting and statistical information on payments";

Elaboration of full scope project to create data storage based on Data Warehouse.

***Development and standardization of information technologies.*** Addressing creation of a single information space in the country, the National Bank of Kazakhstan was involved in elaboration and implementation of governmental programs, investigated new perspective technologies, and developed its own web-site. Transition to a new interface and independent connection of the National Bank of Kazakhstan to SWIFT network was carried out.

***Implementation and support of run information systems.*** Support and administration of 23 sub-systems of IAIS run by the subdivisions and branches of the National Bank of Kazakhstan, were implemented. Based on users' queries 43 reports were elaborated and modified in computerized information system "KUBAZH-3II". Software to collect monthly and annual reporting from organizations engaged in some banking (24 reporting forms) and credit partnerships (13 reporting forms) was finalized and brought into the branches of the National Bank of Kazakhstan. Information is processed monthly and by the end of year and put out in the form of reports to be employed subsequently by the units of the National Bank of Kazakhstan: Division on cash, Division on payment systems, Personnel Department, Accounting Department, Department for research and statistics, and Department of banking and insurance supervision (247 forms).

In 2001, 11 new sub-systems were tested and accepted for support, allowing computerizing the work of Department for research and statistics, Department of banking and insurance supervision, and Division on payment systems. Improvements for 10 sub-systems were finalized to develop maintenance of sub-systems.

***Administration and maintenance of run information systems.*** All branches and structural units were finally moved to Frame Relay protocol with fixed payment per channel. This enables to increase considerably speed of information exchange and ensures more reliable connection furnishing an additional opportunity to connect to the branches via TCP/IP protocol – to solve other tasks (including such tasks as FASTI VIDO and AST).

To reduce the costs of the run systems, a new version of post client FASTI VIDO 2.0 with built-in “Gamma Technologies” cryptography module “Tumar-7” and a wide set of post servers were put in operation, the clients’ work stations were installed and users were trained.

A new version of AST enabling to carry out sessions of key changes with cryptography package “Tumar-7” was introduced. These changes incorporated server’s part SCO UNIX 5.0.5 and work stations with software of clients’ and administrative parts. Installation of new version improves connection reliability, and increases speed of information transfer using cryptographic processing of packages.

RISC servers HP\_UX (Superdome) were accepted in pilot maintenance, and testing was held to check clusters – connection of other block and transfer of Oracle server on this server, in case the former breaks down. The negotiations with Oracle Representation were held to get temporary license for HP-UX to implement further transfer of crucially important subsystems of the National Bank of Kazakhstan on Unix-platform. These measures were carried out in the framework of developing information technologies of the National Bank of Kazakhstan.

***Improvement of technical infrastructure.*** 1513 units of computer equipment were serviced in headquarters (by the end of 2000 – 1421), out of which 112 servers (including branches), 926 personal computers, 70 laptops, 361 laser printers, 25 matrix printers, 12 speedy printers Genicom and 30 scanners. 7 servers and 61 personal computers, which outdated physically and morally, were taken out of maintenance in 2001.

80 servers, 1202 PCs (including 2 laptops), 632 printers including 22 commonly shared Genicom, 455 matrix, 16 PM-815 (subject to write-off), 296 UPS, and 40 scanners were operated in the branches of the National Bank of Kazakhstan.

***Maintenance and technical support of communication and telecoms systems.*** To modernize further the means of communications and telecommunications as well as their development, modern technical equipment was introduced, structured cable networks, telephone and mobile stations were expanded and its quality improved, and technical support of tele and communication equipment was maintained.

To conduct the meetings, video-conference equipment was supplied and installed, and demonstration sessions “Almaty – Astana” were organized. To increase quality of both professional and language (including the official language) training of the specialists of the National Bank of Kazakhstan, linguistic equipment for 12+1 AWS was purchased, delivered and installed for the needs of Personnel Department. Opportunities to deliver services ATS 5ESS-2000 were expanded due to the acquired and installed ATS “Alkatel 4400”. Targeting development of corporate communication network for the institutions of the National Bank of Kazakhstan, 16 managing ATS of “Alkatel” were acquired and supplied to 15 branches and headquarters of the National Bank of Kazakhstan. Additional technical means (servers) were equipped and SCN in Center of cash operations and valuable storage unit was modernized for the Reserve Center of the National Bank of Kazakhstan for 94 AWS. An agreement to install equipment and rent satellite channel in RC (in CCO&VSU) to communicate with the branches of the National Bank of Kazakhstan in Astana city was implemented.

***Acquisition of computer, organizational and special equipment, expansion and modernization of equipment and cable networks.*** To upgrade computer equipment, new technical means were acquired and put in operation:

42 “Dell” servers for the branches of the National Bank of Kazakhstan, 2 sets of graphic stations with color jet printers for Division on cash flows and Banknote factory;

linguistic class equipment (12+1 AWS) for the Personnel Department and videoconferences;

Main servers in cluster (RISC servers) were supplied, equipment was installed in the computer center premises;

580 “COMPAQ” brand personal computers (including 50 laptops) were supplied.

To enhance effectiveness of net security system an equipment of inter-network shield PIX FireWall Cisco 520 was acquired, installed and configured. That in branches of the National Bank of Kazakhstan was Cisco 1720, and that Cisco 2621 - in Center of cash operations and valuable storage unit, Banknote factory and Almaty city branch. 500 KVA UPS for the Reserve Center (RC) and 100 KVA diesel generator for the zone outside the city for emergency occurrence are being acquired.

#### **11.4. Internal Audit**

In 2001, main efforts in improving internal audit system addressed development of legal framework to ensure its best integration with international standards and compliance with regulatory acts of the Republic of Kazakhstan incorporating brought-in amendments and additions. For this, Amendments and additions were made to the Rules of internal auditing, which reflect auditing order for the sub-divisions of the National Bank of Kazakhstan. List of audit areas was worked on further.

To improve audit methods and procedures and increase audit quality, methodological recommendations in four audit areas were elaborated, and amendments and additions were made in the existing methodological recommendations for 2 audit areas. Classification of violations and deficiencies for one of the National Bank’s divisions and questionnaire to be used during audit of repair and construction works were worked out. The works were launched to unify the working sheets in this audit area and interim information forms on issue and cash transactions as well as to ensure conservation of valuables in the branches of the National Bank of Kazakhstan.

A new edition of internal documents was worked out on audit planning and organization in the divisions of the National Bank of Kazakhstan, on preparing and compiling work documentation of such audits, carrying out and documenting post-revision control over audit results.

In 2001, 23 planned audits were held aimed mainly at analyzing reasonability of the incurred expenditures and received incomes of the National Bank of Kazakhstan; assessing information protection and security as well as hardware and software of the National Bank’s information systems; enforcement of Kazakhstani legislation requirements including regulatory acts of the National Bank of Kazakhstan; analysis of whether the internal control measures do suffice and whether tasks and functions imposed on the National Bank’s divisions are executed in a full scope; and whether the exercised procedures suffice to ensure efficient implementation of the tasks put forward for the divisions.

The results of audit checks prove that, in overall, the National Bank’s divisions ensured execution of the imposed tasks and functions although some violations and deficiencies were uncovered. Based on the audit results, the National Bank’s divisions got recommendations to remedy uncovered violations and deficiencies.

Besides, 2 unplanned checks were carried out.

In the first half of 2001, the work of the National Bank’s divisions with “Arthur Andersen” CJSC while it audited the annual report and economic operations of the National Bank of Kazakhstan for 2000, was coordinated and audit results were reconciled. Execution of an agreement by the external auditor was analyzed and measures were worked out to implement the recommendations of external auditors.

In the second half of 2001, audit of the National Bank of Kazakhstan for 2001 was organized and agreement was made with “Arthur Andersen” CJSC.

The candidatures for the positions of chief revisers were selected, activities chief revisers were coordinated, and methodological assistance was delivered to them, their reports were analyzed and the materials on planning, carrying out and realizing checks by them were reviewed.

## 11.5. Financial and Economic Activities

The income and spending of the system of the National Bank of Kazakhstan was 46,2 bln. Tenge and 25,5 bln. Tenge worth, respectively; the net profit (including taxes and minority share) was 20,6 bln. Tenge, of which net profit made by the organizations of the National Bank of Kazakhstan amounted to 391,0 mln. Tenge.

Income of the National Bank of Kazakhstan rose by 24,8% and amounted to 43,4 bln. Tenge, its spending declined by 18,3% and was 23,2 bln. was Tenge. As a result, net retained profit (excluding general provisions 1089,1 mln. Tenge worth) was 20,2 bln. Tenge (Annex 9).

Due to an increase of *gold and foreign exchange assets* of the National Bank of Kazakhstan by 19,7% reaching USD2508,0 mln., the income and costs of managing these assets went up by 26,6% and 2,4 times, amounting to 37,8 bln. Tenge and 7,5 bln. Tenge, respectively. An average yield of managing gold and foreign exchange assets was 7,2% in 2001.

Foreign government securities account for a main share of gold and forex assets of the National Bank of Kazakhstan (over 61%). Due to an increased number of foreign currency securities in the National Bank's portfolio and their price fluctuations, the income and costs of securities operations grew up by 83,5% and 4,5 times, respectively, and amounted, accordingly, to 20,3 bln. Tenge (53,7% of income earned on gold and forex assets) and 5,4 bln. Tenge (72,3%).

In above, in 2001 additional assets in the amount of USD300,0 mln were moved into external management, resulting in total amount of assets managed externally by the end of 2001 over USD619,0 mln., of which over 90% were invested in securities. Due to this, the income earned on these assets increased 3,9 times and were 6060,3 mln. Tenge worth, and costs - 1713,7 mln. Tenge worth.

Income and costs on foreign currency operations went down by 35,5% and 82,5%, respectively, mainly due to lowered liabilities to international financial organizations. In result, the earnings and costs of foreign currency operations were 10,9 bln. Tenge and 323,9 mln. Tenge worth, respectively.

In 2001, due to a hike of interest rate on gold (from 0,34% in 2000 to 0,95% in 2001), the earnings from operations on refined precious metals rose by 37,7% and amounted to 565,9 mln. Tenge.

The National Bank of Kazakhstan did not export gold to the external markets during 2001, and gold purchases and sales were small. Due to this, the operation costs on refined precious metals went down by 30,7% and amounted to 27,1 mln. Tenge.

As a result, the operations on gold and forex assets generated net profit in the amount of 30,3 bln. Tenge.

Due to decreased domestic borrowing by the Government of Kazakhstan, *the volumes of National Bank's operations on government securities in domestic market were reduced.* Alongside, a number of long-term government papers (MEAKAM-10) in portfolio of the National Bank of Kazakhstan declined due to sales. As a result, the earnings of the National Bank of Kazakhstan in the domestic market declined by 25,5% and amounted to 2890,3 mln. Tenge.

The costs rose by 73,8% mainly due to that the Ministry of Finance of Kazakhstan made short-term deposits in the National Bank of Kazakhstan.

In 2001, in order to sterilize broad money, the National Bank of Kazakhstan issued its short-term notes in the amount of 114,3 bln. Tenge (at discounted price) and average weighted yields were at 5,91% per annum. The costs of the National Bank of Kazakhstan to service short-term notes were 1255,2 mln. Tenge.

As a result, the operations in domestic market generated loss in amount of 3305,1 mln. Tenge.

Net income earned in **trust, custodial and broker activities**, amounted to 117,6 mln. Tenge. Out of which, a commission was earned from trust management of the National Fund's assets (since June 2001) in amount of 57,4 mln. Tenge, asset management for other organizations generated income 3,1 mln. Tenge worth, broker servicing of "Development Bank of Kazakhstan" CJSC - 2,4 mln. Tenge, and custodial servicing of "State Accumulative Pension Fund" CJSC and "Central securities depositaries" CJSC - 54,7 mln. Tenge.

**Other income** (income from nullified provisions, reimbursed spending, from rented out fixed assets, sales of golden, silver and other coins, economic operations, windfall income, etc.) rose 2,4 times due to windfall income (nullification of the previously made general bank provisions in amount of 1930,5 mln. Tenge) and amounted to 2600,3 mln. Tenge.

**Other costs** (national currency issue, personnel costs, administrative costs, tax payments, costs on provisions, etc.) declined by 56,0% amounted to 9604,5 mln. Tenge. Reduction of other costs was mainly caused by that provision costs went down by 77,1% (in 2000 provisions on long-term securities of the Government of Kazakhstan were made to bring them to market value as well as loan of RSE "Rehabilitation Fund").

Costs of national currency issue and circulation and its delivery rose by 42,3% and were 1118,6 mln. Tenge worth. To carry out additional measures to protect the national currency from forgery, during 2001 the banknotes were replaced by those of updated design, which differ by additional protecting elements employing the latest relevant technologies.

Costs of operations on fixed and intangible assets and tangible valuables went down by 38,0% to 982,1 mln. Tenge. In 2000, additional depreciation was accrued due to reduced life periods for buildings and facilities of the National Bank of Kazakhstan from 100 down to 40 years (pursuant International Accounting Standards and recommendations of independent audit company).

Personnel costs increased by 29,0% due to recovery of the branches on base of Taldy-Korgan and Kokshetau divisions and incorporation of the National Securities Commissions, and amounted to 2533,6 mln. Tenge.

Unrequited transfers 46,0 mln. Tenge worth were made, including 30,7 mln. Tenge worth - to the pensioners of the National Bank of Kazakhstan, and 10,0 mln. Tenge worth - to the organizations (Children's anti-tuberculosis sanatorium "Chimbulak" - 6,3 mln. Tenge, Baby House № 1 - 1,6 mln. Tenge, Children's gastroenterology center - 0,6 mln. Tenge, RSE "Sardar" of the President's security service - 0,5 mln. Tenge and other).

Administrative costs increased by 13,2%, due to employment of modern telecommunication services and advertising vacancies for the government employee positions, and amounted to 590,1 mln. Tenge.

Tax costs were reduced by 20,2% due to the changes in tax legislation (VAT rate reduction, etc.) and were 313,5 mln. Tenge worth, of which current taxes paid to budget amounted to 21,0 mln. Tenge in total, including VAT for non-residents - 5,4 mln. Tenge, income tax from non-residents - 11,5 mln. Tenge, and other taxes and payments - 4,1 mln. Tenge (on land, property, allocations to Environment protection Fund, etc.)

Capital expenditures rose by 31,3% and amounted to 3409,1 mln. Tenge

In 2001, the National Bank of Kazakhstan acquired the following:

Computers, servers, scanners, and printers in the amount of 313,3 mln. Tenge;

Licensed software products and paid design and research works in amount of 310,8 mln. Tenge;

Equipment to count, sort, pack and destroy national currency in the amount of 228,0 mln. Tenge;

Auto-transport vehicles – 446,7 mln. Tenge;

Guard and alarm equipment, communication devices, special machines and equipment and other in amount of 363,7 mln. Tenge.

788,6 mln. Tenge worth was used to repair buildings and facilities including reconstruction of Central branch building in Astana city.

Besides, the following was allocated:

To replenish authorized capital of:

“Kazakhstani mortgage company” CJSC – 500,0 mln. Tenge;

RSE “Kazakhstani Mint” – 441,6 mln. Tenge;

Authorized capital of “Kazakhstani actuary center” CJSC – 15,0 mln. Tenge

***Subsidiary organizations of the National Bank of Kazakhstan.*** Economic operations of the organizations of the National Bank of Kazakhstan during 2001 are characterized by the following indicators.

Assets of organizations increased by 36,1%, equity capital - 49,2%. High liquidity characterizes financial sustainability of organizations.

Income of the organizations of the National Bank of Kazakhstan generated by sales of products, works and services rose by 27,9% and was 2861,7 mln. Tenge worth, including that of the Republican State Enterprises – 1976,7 mln. Tenge, and that of joint stock companies – 885,0 mln. Tenge.

Costs of productions (products, works, services) increased by 31,0% and amounted to 2318,2 mln. Tenge, of which that of the Republican State Enterprises was 1679,1 mln. Tenge worth, and that of joint stock companies – 639,1 mln. Tenge.

In 2001, organizations of the National Bank of Kazakhstan generated a net income in the amount of 543,1 mln. Tenge, including the Republican State Enterprises – 297,6 mln. Tenge, and joint stock companies – 245,5 mln. Tenge.

After income tax paid to budget in amount of 152,1 mln. Tenge, net income of organizations was 391,0 mln. Tenge worth, of which the Republican State Enterprises – 145,5 mln. Tenge, and joint stock companies – 245,5 mln. Tenge.

Pursuant the established norms, the organizations will transfer their net income in amount of 114,4 mln. Tenge to the National Bank of Kazakhstan with subsequent allocation to the Republican budget, and the remaining amounts will replenish reserve capital and will be left at the disposal of organizations.

The outputs of the activities of the National Bank’s organizations on comparative basis show cost increase (per 1 Tenge of income) and lowered profitability. This is related to that RSE “Motor transport depot” unrequitedly transferred 92 transport vehicles to the government bodies.

An overall profitability of operations of the National Bank’s organizations was 17,3%. In 2001, price policy of the National Bank of Kazakhstan addressed planned reduction of services’ costs. Thus, Kazakhstani center for interbank settlements lowered its tariffs on carrying out electronic payments by about 20%.