COMMERCIAL LAWS OF KAZAKHSTAN
March 2010
AN ASSESSMENT BY THE EBRD

Office of the General Counsel
## CONTENTS

1. **OVERALL ASSESSMENT** ..................................................................................................................................... 1

2. **THE LEGAL SYSTEM** ........................................................................................................................................... 2
    2.1 **CONSTITUTION AND COURTS** .......................................................................................................................... 2
    2.2 **RELATIONSHIP BETWEEN LEGAL TRANSITION AND ECONOMIC PROGRESS** ....................................................... 3
    2.3 **RECENT DEVELOPMENTS IN THE INVESTMENT CLIMATE** ................................................................................. 4

3. **EVALUATION OF SELECTED COMMERCIAL LAWS** .................................................................................. 5
    3.1 **CONCESSIONS** ................................................................................................................................................... 5
    3.2 **CORPORATE GOVERNANCE** .............................................................................................................................. 7
    3.3 **INSOLVENCY** ..................................................................................................................................................... 9
    3.4 **SECURITIES MARKETS** ..................................................................................................................................... 11
    3.5 **SECURED TRANSACTIONS** ........................................................................................................................... 14
    3.6 **TELECOMMUNICATIONS** ................................................................................................................................... 15

**Basis of Assessment:** This document draws on legal assessment work conducted by the Bank (see [www.ebrd.com/law](http://www.ebrd.com/law)) and was last updated during the preparation of the 2009 EBRD Strategy for Kazakhstan, reflecting the situation at that time. The assessment is also grounded on the experience of the Office of the General Counsel in working on legal reform and EBRD investment activities in Kazakhstan and does not constitute legal advice, for further information please contact ltt@ebrd.com
1. **Overall Assessment**

Kazakhstan’s legal environment continues to remain complex and challenging despite notable reforms to its legal system. Over the last few years there have been significant improvements in crucial areas such as securities legislation, concessions, derivative transactions, competition, insolvency and anti-money laundering legislation. Notwithstanding such improvements, Kazakh commercial laws still fall short in certain respects of standards that are generally acceptable internationally. In company law, the major shortcomings are found in the legislation on “disclosure and transparency” and on “ensuring the basis for an effective corporate governance framework”.

Kazakhstan has adopted a policy of promoting PPP, as a result it has undertaken notable efforts to reform concession enabling legislation, in particular, by making amendments in 2008 to the 2006 Concessions Law No. 167-III (the “Concession Law”).

The Insolvency Law appears to be relatively weak in addressing reorganisation processes, liquidation processes and the treatment of estate assets. The means of enforcement of security rights provided by the law seem adequate on the books, yet in practice, enforcement is reported to be problematic due to deficiencies of the court system, uncertainty regarding the enforcement mechanisms, incidents of non-compliance of the government with enforcement rules and decisions, difficulties in locating and ensuring control of the pledged assets and possible application of exchange control rules to repatriation of enforcement proceeds.

Despite progress towards the establishment of a free market-oriented economy, the challenge facing Kazakhstan in 2009 and beyond is still to further enhance the experience, competence and independence of courts, prosecutors and market regulators, tackle corruption, upgrade its commercial laws and make those laws fully effective through a strengthening of the court system and the rule of law.
2. **The Legal System**

2.1 **Constitution and courts**

The Constitution establishes a bicameral legislature consisting of a Senate and an Assembly (Mazhilis). Working jointly, the two chambers have the authority to amend the Constitution, approve the budget, confirm presidential appointees, ratify treaties, declare war, and delegate legislative authority to the President for up to one year. Each chamber also has exclusive powers.

According to article 44 of the Constitution, the President represents the Republic of Kazakhstan in international relations, conducts negotiations, and signs international treaties. The President is the head of state and is elected directly for a maximum of two consecutive seven-year terms. The President appoints, with Parliament’s consent, the Prime Minister, other ministers of the cabinet, the chairperson of the National Bank, and the chairperson of the National Security Committee. The President also appoints the heads of the local government entities, can reverse decisions made by these officials, and has broad authority to issue decrees and overrule actions taken by the ministries.

The court system is a three-tier system composed of: regional courts, district courts and the Supreme Court as the highest judicial body. The regional courts are of common jurisdiction and try most cases in the first instance. The judgments of regional courts may be appealed to the district courts, while decisions of district courts may be appealed to the Supreme Court. There are also specialized courts including military courts, administrative courts and more recently created economic courts. Cases that
are in the competence of the specialized courts are judged in the first instance in the relevant specialized court.

The President nominates judges for appointment to the Supreme Court and the Senate approves them. The President also appoints oblast judges, who are nominated by the Highest Judicial Council, and local judges from a list compiled by the Ministry of Justice. A Constitutional Council, whose members are also appointed by the President and legislature, review, among other things, constitutional questions.

The legal system has made some significant progress since independence. Nevertheless, weaknesses remain in several areas and further reform is needed. Moreover, reform of the court system and judiciary is especially pressing; while the former is progressing slowly, several rulings suggest that judicial independence is very much open to doubt.

2.2 Relationship between legal transition and economic progress.

Kazakhstan has been relatively successful in the transition process. Experience in transition countries suggests that legal transition and economic development progress or regress hand in hand; Kazakhstan is a typical example of this process (see Chart 2). Further success in adopting and implementing new features of the legal framework and improvements in the judiciary should further advance the overall development of the country.

Chart 2 – Rule of law and progress in transition in the EBRD countries of operations

Note: The horizontal axis measures the performance of commercial and financial laws. The vertical axis displays the EBRD transition index as an average of transition indicators between 1997 and 2005, with 1 referring to very early transition stages, and 4 referring to an advanced transition level.

Source: EBRD Transition Report 2009, Table 1.1; EBRD Composite Country Law Index, Mar 2009.

3
2.3 Recent developments in the investment climate

Kazakhstan faces a number of strategic challenges, many of which have been emphasised by the economic and financial crisis:

The crisis has highlighted Kazakhstan’s excessive dependence on primary industries and commodity exports. It is necessary to diversify the economy towards value-added industries, provided this diversification is based on economic rationale. With oil production expected to increase significantly in the coming years and with oil prices rising due to a gradual global economic recovery, the underlying economic tendencies – real exchange rate appreciation and human and financial resources flowing to the hydrocarbon sector – will make economic diversification even more challenging.

The domestic financial sector has proved less developed and on a weaker foundation than previously thought. It is therefore of vital importance to reform the financial sector and to ensure that it emerges from the crisis with a sustainable business and funding model, which can provide sustainable and reliable financial intermediation and lending a lasting source of strength for the real economy. To this end, the banks will need to further develop their local currency funding base and lending products, and strengthen their balance sheets, transparency, and core competencies such as risk management. It is likewise important to further develop local currency and capital markets.

To put sustainable development on a firm footing, the remaining transition gaps in the country’s infrastructure, including shortages and imbalances in power and energy, and transport bottlenecks, need to be filled.

An overarching policy challenge for the Government is to ensure that its efforts to address the impact of the crisis and the country’s medium term transition challenges do not result in undue and lasting interference in the economy and erosion of market principles. In the private sector, fair competition on a level playing field needs to be preserved and in some cases improved as economic incentives are re-designed.

Kazakhstan agreed in June 2009 to form a customs union with Russia and Belarus and seek joint accession to the WTO. The move was opposed by the European Union and the United States. However the economic advantages of the customs union for Kazakhstan were clearly set out by President Nazarbayev, the expected increase in the trade volume, improvement of the investment climate within the customs union, free movement of labor, capital and goods in the common customs space and better access to outside markets for domestic producers. Some Government members believe that the customs union will damage Kazakhstan’s national interest and threaten its independent economic policy, prompting observers to think that the motivation to join was political more than economic. The customs code is due to come into force in July 2010,
3. Evaluation of selected commercial laws

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: concessions, corporate governance, insolvency, secured transactions, securities markets and telecommunications. The existing tools assess both the quality of the laws “on the books” (also referred to as “extensiveness”) and the actual implementation of such laws (also referred to as “effectiveness”). This annex presents a summary of the results for Kazakhstan, accompanied by critical comments of the Bank’s legal experts who have conducted the assessments.

All available results of these assessments can be found at www.ebrd.com/law.

3.1 Concessions

As a result of a PPP promoting policy Kazakhstan has recently undertaken notable efforts in reforming concession enabling legislation, in particular, by making amendments in 2008 to the 2006 Concessions Law No. 167-III (the “Concession Law”). In addition, a National PPP Unit was set up in 2008 under the Ministry of Economy (“MoE”) to improve the PPP institutional framework.

The current Kazakhstan Concession Law enables the implementation of concession in infrastructure including those based on open tendering. The July 2008 amendments to the Concession Law addressed a number of major flaws, relating to definitions, model contract provisions, register of concessions, deadline period to conclude concession contract, and limits to state guarantees.

Overall, the amended Concession Law is now seen as adequate; however, the law still falls short in certain aspects of internationally acceptable standards. The main areas for improvement remain as follows:

- Security issues may present a significant obstacle to the bankability of potential projects as pledge of assets is still not allowed (although it may be possible to pledge shares in a concessionaire);
- The delineation of powers of certain authorities in the tendering process is still not sufficiently clear;
- The list of assets referred to in the Concession Law is to be approved by the Government which adds uncertainty, in particular for unsolicited proposals;
- The qualification requirements are merely factual/quantitative rather than quality criteria that would allow selection based on expertise. It is not clear at this stage whether the grantor is allowed to further qualify the requirements in the tender documents as practice so far has been restrictive. The methodologies are still to be developed by the PPP Unit and approved by the MoE;
- The Concession Law still limits the negotiation time for entering into agreements to no more than 90 days which may hamper the financing on the part of IFIs.
The authorities appear to be aware of remaining issues and have chosen to proceed with initial concessions first by way of testing the market and collecting potential bidders views as to what is necessary to be addressed through any further legislative amendments in order to make the regime more attractive (see Charts 3 and 4).

Chart 3 - Quality of concessions related legislation in the EBRD countries of operations

Note: The various categories represent the level of compliance of a given country’s legislation (“the laws on the books”) with international standards such as the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects. The asterisk indicates in which category Kazakhstan ranks.

Source: EBRD concessions sector assessment 2007/08.
3.2 Corporate Governance

The principal legislation governing corporate governance in Kazakhstan is the Law on Joint Stock Companies (JSC Law) dated 13 May 2003 (Law No. 415-II dated 13 May 2003), as amended.

A voluntary Corporate Governance Code was approved by the Council of Issuers on 21 February 2005 and by the Council of the Association of Financiers on 31 March 2005. The Code was revised in July 2007. Both the JSC Law and Stock Exchange Listing Rules refer to the Code but companies are only recommended to transpose the code’s recommendations in their by-laws. No compliance statement is required.

The EBRD’s 2007 Corporate Governance Sector Assessment assessed the quality of corporate governance legislation in force in November 2007; Kazakhstan was found to be in “medium compliance” with the relevant international standards (the OECD Principles of Corporate Governance). The major shortcomings were found in the legislation on “disclosure and transparency” and on “ensuring the basis for an effective corporate governance framework” (see the Charts 5 and 6).
When assessing how corporate governance legislation works in practice in 2005, the EBRD found that the effectiveness of legal procedures for obtaining disclosure in Kazakhstan are undermined by their complexity, the difficult of enforcement and the length of the proceedings. Complexity was also identified as a problem for redress procedures. When considering the institutional environment, while the survey evidenced that company information is generally of good quality, the statutory auditors fairly independent and the legal framework on related party transactions adequate, partiality of judgements and corruption are considered major problems. As a result, enhancing the experience and competence of courts, prosecutors and market regulators should be tackled as priorities.

Chart 5 - Quality of corporate governance legislation in the EBRD countries of operations

*Note: The various categories represent the level of compliance of a country’s legislation (the “laws on the books”) with international standards as set out in the OECD Principles of Corporate Governance. The asterisk indicates in which category Kazakhstan ranks.*

*Source: EBRD corporate governance sector assessment 2008.*
Chart 6 - Quality of corporate governance legislation in Kazakhstan (2008)

Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles.

Source: EBRD Corporate Governance Sector Assessment, 2008 assessment.

3.3 Insolvency

A complete assessment of all insolvency laws in the EBRD’s countries of operations, including Kazakhstan, was recently completed in 2009. The assessed compliance score for the general insolvency law assessment was 61%, indicating ‘low compliance’ (see Charts 7 and 8).

In the 2006 assessment Kazakhstan was rated as ‘medium compliant’. This suggests that subsequent changes to the law have not improved it. It is weak in the areas of commencement, assets of the estate, credits rights and reorganisation. Examples of these weaknesses are:

- Commencement: The law does not apply to state owned enterprises, there is no provision for a filing by a debtor based on anticipated or ‘expected’ insolvency, jurisdiction is with non-commercial courts and judges, it is unclear if the stay covers secured creditors and, if so, the limitation on their rights, the stay does not cover third parties who own property leased, hired or occupied by the insolvent debtor or retention of title creditors.
- Assets: No safeguards requiring delivery up/protection of assets, not provisions requiring a debtor or third parties to provide information concerning assets. The avoidance of pre-bankruptcy transactions is weak, vague and unsatisfactory.
- Creditors: No provisions for set-off.
• Reorganisation: No restriction on suppliers of essential services, no requirement for disclosure of material information regarding a proposed plan, no minimum standards by which a plan may be judged, no provision for ongoing finance requirements, approval process is sub-standard, no restrictions on voting by ‘connected’ creditors. There are no provisions for cross-border insolvency.

This year the assessment included a special part (part F) on the law relating to insolvency office holders (trustees, administrators etc.). The assessment in this area was based upon the EBRD Office Holder Principles (‘the principles’) that were developed in 2007. It is an important area for assessment since in almost every case the respective laws of the countries that are assessed require the appointment of an office holder to administer the case. The quality of insolvency office holders, their appointment and supervision may have a crucial impact on efficient implementation of the law. This area was therefore selected to be assessed in depth and rated separately. The law is defective regarding qualifications and disqualification of insolvency office holders. There is no provision for the review of an office holder and the provisions relating to removal/retirement and replacement of an office holder are inadequate. There are no professional work standards and no rules of ethical conduct. There is no requirement for professional indemnity insurance.

Chart 7- Quality of insolvency legislation in Kazakhstan (2009)

Note: The extremity of each axis represents an ideal score, i.e. corresponding to international standards such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group’s “Legislative Guidelines for Insolvency Law”, and others.

3.4 Securities markets

The basic legislation on the securities markets in Kazakhstan is contained in the Law on Securities Market (Law No. 461-II dated 2 July 2003), in the Law on Investment Funds (Law No. 576-II dated 7 July 2004), in the Law on Joint-Stock Companies (Law No. 415-II dated 13 May 2003) and in several acts of the secondary legislation issued by the regulator.

In February 2006, the Regional Financial Centre of Almaty (the “RFCA”) was created. The RFCA is a Government initiative to create a financial market operating to internationally recognised standards of market regulation and best practices. It is a separate trading platform of the Kazakhstan Stock Exchange with simplified access for non-residents and its own listing rules. The RFCA is managed and supervised by the Agency of the Republic of Kazakhstan for regulation of the activity of the RFCA, which reports directly to the President of the Republic of Kazakhstan. Disputes between RFCA members are solved either through the specialised financial court of RFCA or court of arbitration.

The securities market regulator is the Agency for Regulation and Control over the Financial Market and Financial Entities (the “Agency”), which is responsible for regulation and supervision of banks and entities performing certain types of banking transactions, insurance companies, securities market entities and accumulation pension funds.
According to the EBRD Securities Markets Legislation Assessment conducted in 2007, the country was found to be in “medium compliance” with the Objectives and Principles of Securities Regulation published by the International Organization of Securities Commissions (IOSCO) – see Charts 9 and 10 below - showing a number of shortcomings in the securities markets legal framework, especially in the “clearing and settlement”, “money laundering” and “financial instruments” sections. Since the completion of the EBRD assessment, a number of improvements have been introduced. In particular, a new Anti-Money Laundering Law was adopted by both Chambers of the Kazakh Parliament in June 2009 and signed by the President in August 2009, and on 12 December 2008 a set of provisions addressing derivatives was incorporated into the Civil Code.

Chart 9 – Quality of securities market legislation in the EBRD countries of operations

Note: The various categories represent the level of compliance of a given country’s legislation (the “laws on the books”) with international standards such as the IOSCO Principles. The asterisk indicates in which category Kazakhstan ranks.

In 2007 the EBRD assessed how securities markets legislation works in practice. The survey revealed that although many Kazakh companies have carried IPOs, only a few placements have been done nationally. Financial reporting is in line with IFRS but no official translation of these standards is available. Doubts are cast over the reliability of prospectuses due to the mild sanctions for providing inaccurate or misleading information. The Agency is in charge for the supervision of prospectuses and underwriters but there is little supervision of the IPO process in Kazakhstan. The Agency’s sanctioning powers are limited: it can issue sanctions against an issuer only if an investor makes a complaint about a specific failure to publish a notice or provide a prospectus upon request.
3.5 Secured Transactions

Security rights over property are governed by the Civil Code of the Republic of Kazakhstan, adopted in December 1994 and other laws.

There are two main types of security over movable assets (pledges) under Kazakh law: possessory (where the possession of the collateral is transferred to the creditor) and non-possessory (where the debtor may retain the collateral during the life of the security and use it). The registration system is two-tier: there is a mandatory registration, which applies to specific types of assets such as motor vehicles, aircraft etc. These assets are registered in specific registries and the pledge should be registered there too (e.g. the policy for pledges over motor vehicles). For all other types of assets, pledge registration is voluntary only and is conducted in the Centres for Registration of Immovable Property and their subsidiaries. There is no centralised registry but 16 separate Centres in two major cities, Astana and Almaty, and in each region. The registries are supervised by the Registration Service Committee under the Ministry of Justice in Astana. Most of the registries have computerised databases which are accessible through the respective registrar.

Based on an EBRD assessment, the secured transactions legal regime is adequate, although not particularly enabling for sophisticated transactions. Some transactions remain complex to achieve. For example, a pledge over assets described generally would not be a viable option to secure a transaction since the law provides that the pledge agreement must specify the assets and their value or a method for their valuation. If the pledge is registered, a list and description of the pledged assets must be entered in the registry. General description would be possible for pledges over goods in circulation and processing (merchandise stock, raw materials, materials, semi-finished products, finished products and the like), where the debtor could change the composition and natural form of the pledged assets provided that their overall value would remain the same as prescribed in the pledge agreement. Such condition would be difficult to fulfil as the debtor who would have to renew its stock at all times. Practitioners have expressed some concerns on the efficiency of the registration process - bureaucratic and corrupt environment makes it hard to use the system. Search requests take up to five days, depending on work load, but considerable delays are also reported. The Bank has in the past experienced unacceptably long delays in perfecting its security rights over the borrower’s assets.

Finally, the means of enforcement provided by the law seem adequate on the books, yet in practice, enforcement is reported to be problematic due to deficiencies of the court system, uncertainty regarding the enforcement mechanisms, incidents of non-compliance of the government with enforcement rules and decisions, difficulties in locating and ensuring control of the pledged assets and possible application of exchange control rules to repatriation of enforcement proceeds. Serious delays could occur due to the right of the court to postpone the sale of the pledged property up to one year upon the debtor's request. EBRD surveys have highlighted serious problems, in particular the high risk of court corruption and the lack of training of key enforcement officers, such as the bailiffs.
Security over immovable assets (mortgages) is covered primarily by the 1995 Presidential Decree (having the force of law) on Mortgage of Immovable Property. The Kazakh residential mortgage market has expanded considerably in the last few years and, generally speaking, the legal framework has supported such expansion. There is no specific form required for a mortgage agreement but parties often have the agreement notarised. Mortgage agreement must specify the principal obligation, its amount and the due date which makes it impossible to secure a debt described generally or a fluctuating debt. An enterprise can be charged by way of a mortgage, where the security will cover all the enterprise’s movable and immovable assets, claims and exclusive rights, including those obtained during the mortgage period, "main and circulating funds", and securities on its balance sheet.

To be valid, the mortgage must be registered in the Real Estate Register, which is maintained by the Registration Service Committee - a state enterprise under supervision of the Ministry of Justice which has local registration offices across the country. The Register is paper-based and not centralised. The application for registration must be accompanied by a deed confirming ownership title to the mortgaged property. It is frequently the mortgage creditor who applies for registration in which case he must present a power of attorney signed by the mortgagor. The process is cumbersome and it takes about 3 weeks, however, banks reportedly disburse mortgage credit prior to completing registration.

Mortgage right enjoys priority in the mortgaged property from the moment of its entry in the Register. In the event of bankruptcy priority of a mortgage right is superseded by preferential claims for damage to health and alimony.

In case of the mortgagor’s default the mortgage right can be realised in judicial procedure or in an out-of-court sale by means of a public auction carried out by a trustee who is either determined in the mortgage agreement or by decision of the mortgage creditor. Enforcement is reported to work efficiently. As for pledges, difficulties may arise with debtor’s obstruction, which can significantly prolong the procedure especially if postponement of enforcement by up to one year has been granted by a court.

2.6. **Telecommunications**

*Institutional framework:* Until 2007, the telecommunications sector (the “Sector”) in Kazakhstan was regulated by three separate entities: the Agency for Communications and Informatics (AIC) which regulated technical matters and universal service; the Agency for Natural Monopolies (AREM), which regulated interconnection; and, the Committee for the Protection of Competition (CPC), responsible for assessment of dominance and application of retail tariff regulation. (The CPC was replaced by the Agency for Protection of Competition (APK) in 2008). In 2007 all relevant powers to regulate the sector were transferred to AIC. AIC is also now responsible for Sector policy making and Informatisation issues.
Regulatory independence: Since 2007, AIC has attempted to take independent action but meaningful reforms have yet to be implemented. The Government of Kazakhstan (the “Government”) maintains control of 51% of the dominant incumbent operator, KazakhTelekom (KTC), through its Samruk Holding organisation, which also owns 100% of one of KTC’s main competitor, TransTelekom. The sector regulator AIC has produced progressive regulatory proposals for retail tariff rebalancing, market access and interconnection charging but these have not yet been implemented by KTC. Thus, as the necessary market remedies have yet to be implemented, regulatory independence is still only a theoretical concept in Kazakhstan.

Assessment: In a 2008 assessment of the communications sector of EBRD Countries of Operation the sector regulatory regime in Kazakhstan was deemed to have “Low Compliance” when measured against international best practice (see charts below).

Chart 11 - Quality of telecommunications regulatory framework in Kazakhstan (2008)

Note: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the “web”, the closer the overall telecommunications regulatory framework of the country approximates these standards.

12(a) Fixed Network Penetration

12(b) Mobile Network Penetration
12(c) Broadband Network Penetration

**Note:** Key indicators for Belarus provide the fixed network penetration defined as active subscriber lines as a percentage of population, mobile network penetration defined as active pre- and post-paid subscribers as a percentage of population and the broadband network penetration defined as the number of access subscribers with speeds of 144k/bits or more as a percentage of population (broadband Network Penetration less than 1% is not shown on this chart).

**Source:** EBRD Telecommunications Regulatory Assessment, 2008.