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DEVELOPMENT OF BANKING INTERACTION BETWEEN KAZAKHSTAN AND CHINA

In modern economic conditions, the efficiency of the banking sector affects the development of not only the financial and economic system of the state, but also ensures the financial stability of the national economy as a whole. Considering the processes of globalization and liberalization of financial markets, as well as the growing demand of consumers of financial services, attention is being paid to the banking sector both from academics and from the management of banking institutions at various levels of government. All this causes a special interest in the banking sector of the Republic of Kazakhstan. The article explores the features of the development of the banking sector of the Republic of Kazakhstan in the conditions of the infusion of Chinese banks into the banking system. On the example of the work of Chinese banks within the country and in the global financial space, recommendations on ways to improve legislation on the banking system of Kazakhstan are made. According to current global trends in the financial market, the banking sector is entering a qualitatively new level of functioning, which leads to its analysis and identification of its structure in the Republic of Kazakhstan. The current state of the banking sector of the Republic of Kazakhstan in the context of globalization processes is analyzed. Key factors influencing the development of the banking sector of the Republic of Kazakhstan are identified. The problems and directions of development of the banking sector of the Republic of Kazakhstan at the present stage are identified.

Key words: banking law, banking system, foreign banks, banking legislation.

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Қазақстан және Қытай арасындағы банк саласындағы қарым-қатынастың дамуы

Қазіргі экономикалық жағдайда банк секторы қызметінің тиімділігі мемлекеттің қаржылық-экономикалық жүйесін дамытып ғана қоймай, сондай-ақ тұтастай алғанда ұлттық экономиканың қаржылық тұрақтылығын қамтамасыз етеді. Жаһандану үрдістерін және қаржы нарықтарының либерализациясын, сондай-ақ қаржылық қызмет тұтынушыларының сұранысын ескере отырып, банк секторына ғалымдар да, банк мекемелерінің басшылығы және әр түрлі деңгейдегі мемлекеттік органдардың назары арта бастады. Мұның бәрі Қазақстан Республикасының банк секторына ерекше қызығушылық тудырады. Мақалада қытай банктерін банк жүйесіне енгізу жағдайында Қазақстан Республикасының банк секторының даму ерекшеліктері қарастырылады. Елдегі және жаһандық қаржы кеңістігінде қытай банктерінің жұмысының мысалында

Қазақстанның банк жүйесіндегі заңнаманы жетілдіру жолдары туралы ұсыныстар жасалды. Қаржы нарығындағы қазіргі жаһандық үрдістерге сәйкес, банк секторы өзінің қызметін сапалы жаңа деңгейге шығарады, бұл оның талдауына және Қазақстан Республикасында өз құрылымының ерекшеліктерін анықтауға әкеледі. Қазақстан Республикасының банк секторының қазіргі жағдайы жаһандану үрдістері жағдайында талданды. Қазақстан Республикасының банк секторының дамуына әсер ететін негізгі факторлар анықталды. Қазіргі кезеңде Қазақстан Республикасының банк секторының дамуының бағыттары мен мәселелері анықталды.

Түйін сөздер: банк құқығы, банк жүйесі, шетел банкі, банк заңнамасы.

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Развитие банковского взаимодействия между Казахстаном и Китаем

В современных экономических условиях эффективность функционирования банковского сектора не только влияет на развитие финансово-экономической системы государства, но и обеспечивает финансовую стабильность национальной экономики в целом. Учитывая процессы глобализации и либерализации финансовых рынков, а также возрастающий спрос потребителей финансовых услуг, повышается внимание к банковскому сектору как со стороны ученых, так и со стороны руководства банковских учреждений разных уровней управления. Все это обуславливает особый интерес к банковскому сектору Республики Казахстан. В статье исследованы особенности развития банковского сектора Республики Казахстан в условиях вливания в банковскую систему банков КНР. На примере работы китайских банков внутри страны и в мировом финансовом пространстве внесены рекомендации по направлениям совершенствования законодательства о банковской системе Казахстана. Согласно современным мировым тенденциям финансового рынка банковский сектор выходит на качественно новый уровень функционирования, что побуждает к его анализу и выявлению особенностей его структуры в Республике Казахстан. Проанализировано современное состояние банковского сектора Республики Казахстан в условиях глобализационных процессов. Выявлены ключевые факторы, влияющие на развитие банковского сектора Республики Казахстан. Определены проблемы и направления развития банковского сектора Республики Казахстан на современном этапе.

Ключевые слова: банковское право, банковская система, иностранные банки, банковское законодательство.

The relevance of research

The integration of Kazakhstan into the global financial system was reflected in the dependence of the banking sector on the conjuncture in the global markets, which negatively affected the activities of leading domestic banks. Crisis phenomena, either explicitly or hidden, have accumulated over the past few years and were due to a number of factors. Thus, according to specialists, “the problems of banks manifested themselves in the imperfection and inconsistency of risk management systems with current trends and the level of accepted risks, both in degree and quality of risks, in a low level of corporate management, inadequate transparency of banking business and, as a result, business inefficiency -models that are sensitive to negative trends. The world crisis, on the one hand, revealed problems and

weak points of development, and on the other hand, it provides an opportunity for self-renewal for the banking sector of Kazakhstan, which functioned in difficult conditions due to the persistence of instability in world markets” (Kuzgibekov 2018).

The weakness of the banking system has become apparent in the last 2-3 years. This was especially acute in 2018. Many domestic and foreign financial players left the country’s economic market, which also adversely affected the rating of the country’s banking system. At the same time, financial analysts note that, against this background, the role of foreign banks has seriously increased.

Deposits of Kazakhstanis are slowly flowing into foreign banks: the share of retail deposits in STBs with foreign participation increased from 10% to 11% over the year. The main “foreign banks” are Russian “subsidiaries” (Rating of Kazakhstan banks

– 2018). The volume of deposits over the past year for the first time in several years has decreased – by 3.4%, that is, to 16.7 trillion tenge. Corporate deposits decreased by 9.7% – to 8.5 trillion tenge. At the same time, retail deposits continued to grow – in 2017 by 4% – to 8.2 trillion tenge. As a result, the share of individuals' deposits in the total volume of deposits of second-tier countries increased over the year from 45.8% to 49.3%.

As of January 1 of the current year, the country's banking sector is represented by 32 second-tier banks, of which 13 are with foreign participation. The share of deposits in banks of the Republic of Kazakhstan with foreign participation in the deposit portfolio has been growing for the second year in a row.

In addition, and the banking sector includes banks in China, which have significant capital and are able to dictate the rules of the game.

Main part

The banking sector is an important component of the national economy of any country. It is advisable to highlight the features of the banking sector of the Republic of Kazakhstan:

- covers a specific activity that is related to the monetary sphere;
- dynamic behavior of banking institutions;
- ability to self-regulation and self-development;
- the complexity of the relationship system;
- a large number of constituent elements of the banking sector, which are equally aimed at maximizing profits and increasing liquidity;
- active introduction of modern information and communication technologies in customer service;
- constant search for new ideas to ensure innovative development (Nazarov 2016: 97-98).

The legal basis for regulating the activities of the banking system is the Law of the Republic of Kazakhstan “On the National Bank”, the Law of the Republic of Kazakhstan “On banks and banking activities in the Republic of Kazakhstan” and the Law of the Republic of Kazakhstan “On currency regulation and currency control”. On the basis of these acts, decisions of the National Bank of the Republic of Kazakhstan are adopted, which directly regulate this sphere.

The National Bank of Kazakhstan is the only body that determines and implements the state monetary policy of the Republic of Kazakhstan, the purpose of which is to ensure price stability in the country.

Kazakhstan has a two-tier banking system. The first level bank – the National Bank is the

central bank of the Republic of Kazakhstan and represents the top (first) level of the banking system of the Republic of Kazakhstan. He represents the interests of the Republic of Kazakhstan in relations with central banks and banks of other countries, in international banks and other financial and credit organizations. Its legal status is determined by the Constitution of the Republic of Kazakhstan of August 30, 1995 and the Law of the Republic of Kazakhstan “On the National Bank of the Republic of Kazakhstan” of March 30, 1995 No. 2155. The National Bank reports directly to the President of the Republic of Kazakhstan and is not responsible for the obligations of the Government of Kazakhstan.

The National Bank is the authorized body that regulates, controls and supervises banking activities in the country. It creates general conditions for the functioning of banks and organizations engaged in certain types of banking operations.

Second-tier banks are the remaining banks that have received a license from the National Bank to conduct banking activities in Kazakhstan. Thus, at present, there are 35 second-tier banks in the country, including foreign banks (Russia, China, Pakistan, etc.), including the Islamic Bank.

The National Bank sets the criteria for obtaining permission to open a bank. The Central Bank acts on the basis of the Resolution of the Board of the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations No. 121 of April 30, 2007 “On Approval of the Rules for Issuing Permits for Opening a Bank, as well as Licensing Banking and Other Operations, Activities in the Securities Market by Banks” (Decisions of the Board of the Agency of the Republic of Kazakhstan 2007).

Banks are not responsible for the obligations of the state, as well as the state is not responsible for their obligations, except in cases where banks or the state assume such responsibility. At the same time, the state guarantees the safety of deposits accepted by interstate banks – residents of the Republic of Kazakhstan, and is liable for their obligations in proportion to the share of the Government of the Republic of Kazakhstan in the authorized capital of such banks.

The authorized capital of the bank is formed only in the national currency of the Republic of Kazakhstan. The size stated in the Charter of the Bank must be fully ensured within 1 year after receiving permission to open a bank with the subsequent receipt of a license (Law of the Republic of Kazakhstan 1995).

The founders and shareholders of the bank may be legal entities and individuals – residents and non-residents of the Republic of Kazakhstan. At the same time, the National Bank monitors its business reputation and financial viability. The conditions for creating bank holding companies and acquiring the status of a major participant in a bank are determined by law, while the National Bank reserves the right to refuse to assign such status and, accordingly, buy back a certain number of bank shares.

For a bank with the participation of non-residents of the Republic of Kazakhstan, additional requirements for establishment are established. Thus, a non-resident individual or legal entity who is the founder of a bank, in addition to documents, must attach to the application for issuing permission to open a bank written notification to the authorized body of the relevant state that the person is allowed to own shares of the resident bank of the Republic of Kazakhstan or body of the relevant state that such a permit under the laws of the state of the specified founder is not required.

Currently, foreign banks and insurance companies can work in the country only through subsidiaries – residents of Kazakhstan. A non-resident bank of the Republic of Kazakhstan has the right to open its representative office without obtaining the consent of the authorized body, but within thirty working days from the date of registration in the justice authorities must notify the authorized body in writing with the application:

1) a notarized copy of the provision on representation with the mark and stamp of the registered justice authority;

2) written confirmation of the banking supervision authority of the relevant state that the non-resident bank of the Republic of Kazakhstan has a valid license for banking activities;

3) a written notification of the banking supervision authority of the relevant state that he does not object to the opening of a representative office of a non-resident bank of the Republic of Kazakhstan in the territory of the Republic of Kazakhstan, or a statement from the banking supervision authority or the authoritative legal service of the relevant state that such permission by the legislation of the state of the bank – non-resident of the Republic of Kazakhstan is not required;

4) a notarized power of attorney addressed to the head of the representative office of the bank.

Opening branches of nonresident banks in the Republic of Kazakhstan is prohibited. The National Bank is entitled to demand the closure of a branch or additional premises of a branch or representative

office of a resident bank and a representative office of a non-resident bank of the Republic of Kazakhstan.

The growth of the world economy, according to the IMF, will be 3.7% in 2018 and 2019, after a slowdown in 2015-2016. The main contribution, as before, will be provided by the developing countries of Asia, in particular, the Chinese economy will show an increase of 6.6% in 2018, with a slowdown to 6.2% in 2019.

The National Bank of Kazakhstan is implementing the “Program for improving the financial stability of banks”, which has already allowed to minimize systemic risks and find a solution to long-standing problems in the banking sector. In addition, it gives an important impetus to the economic development of the country by increasing bank lending, the “Program to improve the financial sustainability of banks” (Resolution of the Board of the National Bank of June 30 2017) in 2017 and the creation of the Kazakhstan Sustainability Fund, which supports financial institutions. The first stage of the program provided for the immediate reorganization of banks. A successful solution was found to save the backbone Kazkommertsbank. His potential bankruptcy could lead to large losses and reputational risks for the entire banking system.

In addition, at the first stage of the program, five other large Kazakhstani banks were assisted and provided state support in the amount of 653.7 billion tenge (1.9 billion US dollars). The head of the National Bank noted that with the transition to a floating exchange rate in 2015, systemic liquidity risk and dollarization decreased significantly, which led to an unprecedented visibility and predictability of interest rates and monetary conditions for Kazakhstan. The liquidity condition of the banking sector is assessed as stable against the background of the continuing surplus. The total amount of highly liquid assets, both in tenge and in foreign currency as of September 1, 2018, amounted to 8.5 trillion tenge, which covers about 40% of total liabilities of banks. Currency risks associated with dollar liabilities remain manageable, mainly because dollarization has declined. Thus, the dollarization of deposits decreased to 47% by the end of August 2018, while at the beginning of 2016 this figure was 72%. Banks accumulated capital and minimized risky assets, which led to an increase in capital adequacy from 16.3% at the beginning of 2017 to 20.9% on September 1 of the current year (National Bank: from stabilizing the banking sector to sustained economic growth).

The second stage of the stabilization program is focused on improving the banking system as a

whole. The task of the regulator is not to identify problems after they appear, but to prevent them from occurring initially. Significant changes were made to the legislation, which entered into force on January 1, 2019. In addition to the above measures, the legislative framework for the rehabilitation of banks in Kazakhstan was conceptually revised to improve its efficiency. The Board of the National Bank on February 6, 2018 decided to complete the implementation of the program in terms of measures to recapitalize large banks. On February 7, 2018, consideration of applications of banks was discontinued, and those applications that had already been received before this deadline would remain without consideration, he said. The head of the National Bank noted that international experience indicates that “support programs should cover only large institutions for financial stability in the country” (The National Bank will no longer capitalize the large banks as part of their recovery).

Fundamental methods of reorganization of banks, widely used in international practice, including the bail-in mechanism, are being introduced. These changes are aimed at minimizing budget expenditures for the financial rehabilitation of problem banks and reducing the risk of bad faith. As part of the legislative amendments, the mechanism of the National Bank, as the lender of last resort, was improved in accordance with international best practices, implementing principles such as providing fully secured loans only to solvent banks at market rates. In addition, the National Bank expands the list of acceptable collateral for this mechanism, including non-market assets. Such changes contribute to the stability of the financial system, since they can increase market discipline and prevent the solvent bank from failing to fulfill its obligations and, consequently, systemic risks that arise. The Kazakhstan Banking Sector Stabilization Program is a long-term, systemic and preventive measure. Positive changes are reflected in the updated forecasts of Kazakhstan’s economic growth. Recently, the Asian Development Bank has improved its forecast for Kazakhstan’s GDP growth from 3.2% to 3.7% in 2018 and from 3.5% to 3.9%, respectively, in 2019.

China is one of the key trade partners of Kazakhstan. According to the results of 2017 the foreign trade turnover between the countries increased by more than 30%.

Currently, Kazakhstan and China are implementing 51 joint projects in the field of industry, transport and logistics in the amount of \$ 28 billion. As part of the Kazakhstan-China Forum, held in

early September in Astana, it was noted that China, together with other financial institutions, provided support in the amount of more than \$ 50 billion for the construction of projects in Kazakhstan (Press release of the Embassy of the People’s Republic of China in the Republic of Kazakhstan 2018).

Cooperation between countries in the framework of the revival of the Silk Road is observed in all spheres: cultural, political and economic. The total investment in Kazakhstan has already exceeded \$ 43 billion. China ranks fourth in terms of investment in Kazakhstan. In Kazakhstan, there are more than 1,200 enterprises with the participation of Chinese capital in the oil and gas, chemical and food industries, as well as in banking, engineering, logistics and other fields.

Today in Kazakhstan there are 13 banks with foreign participation. The total amount of assets of foreign players by the end of April 2018 amounted to 4.09 trillion tenge. Since the beginning of the year, the assets of these banks have grown by 2.6%. The share of banks with foreign participation in the total assets of the banking sector over the past 12 months increased from 14.8% to 17.1%.

The share of Chinese banks in the credit market of Kazakhstan is only 0.3%, but this is 10 times more than in 2010 (Analysis of the banking sector of Kazakhstan – RA RFCA).

Today, representatives of two banks from the “big four” operate in Kazakhstan – JSC Subsidiary Bank Bank of China Kazakhstan and Bank of China in Kazakhstan and JSC ICBC Almaty (Bank of China in Almaty).

Since 2010, the share of Chinese banks in the credit market of Kazakhstan has increased 10 times, however, it remains quite insignificant – only 0.3%. The highest rate was recorded in 2015, when the total share of the loan portfolio of China TPB and Bank of China was 0.4%.

Until 2018, the Bank of China in Kazakhstan was the leader among the two banks in terms of the loan portfolio, with a volume of 11.7 billion tenge versus 10.4 billion tenge of TPB China. But by the end of 2015, the TPB of China took the lead with a volume of 38.7 billion tenge versus 17.9 billion tenge of the Bank of China. At the end of December 2017, the volume of the loan portfolio of the TPB of China was 25.3 billion tenge, which is 25.8% less than a year earlier. The volume of loans of the Bank of China for the year increased by 1.8% to 12.7 billion tenge (Bank of China Kazakhstan).

On June 7, 2017, the People’s Bank of Kazakhstan signed an agreement with China CITIC Bank Corporation Limited and

ChinaShuangweiInvestmentCo. Ltd. on the sale of 60% in the share capital of JSC AltynBank (a subsidiary wholly owned by Halyk Bank). This will strengthen the position of Chinese banks in the banking sector of Kazakhstan and increase their share from 0.3% at once to 1.1%.

The Bank of China in Kazakhstan is a subsidiary of the Bank of China, the oldest Chinese bank. JSC SB Bank of China in Kazakhstan was opened in 1993, and the main activity of this financial institution is the provision of a wide range of financial transaction services, as well as deposit programs, both for large corporations and for small commercial enterprises.

It must be borne in mind that, thanks to large volumes of financial assets and a wide network of branches of Bank of China, and its partner banks around the world, Subsidiary Bank Bank of China in Kazakhstan can provide services to the widest consumer sector from small and medium businesses to industrial giants and transnational corporations. According to the Internet portal Banker.kz, the financial indicators of the Bank of China in Kazakhstan are quite high. So, at the end of April 2015, the bank's assets amounted to 191,103,609 thousand tenge, own capital – 17,137 856 thousand tenge. Thus, Subsidiary Bank JSC Bank of China in Kazakhstan ranked 21st in the rating of Kazakhstan banks in terms of assets and 23rd in terms of capital (<https://allbanks.kz/banks/bank/Bank-Kitaya-v-Kazahstane>).

An important event for the Bank of China in Kazakhstan was the assignment of the status of market maker for the Chinese yuan. This event took place on September 25, 2014 in the trading floor of the Kazakhstan Stock Exchange (KASE) during the grand opening of trading of the Chinese yuan / Kazakhstan tenge currency pair. The opening of exchange trading in the Chinese yuan will contribute to the growth of the share of exchange transactions and increase in the volume of foreign exchange markets, as well as strengthen the role of the tenge in the international arena. The main objective of the new currency instrument is to support the increasing volumes of direct trade operations between Kazakhstan and China. JSC DB “Bank of China in Kazakhstan” will contribute to the development of Kazakhstan-China trade and economic relations, providing access to direct exchange of currencies of the two countries, mutually beneficial for both economies.

The representative of the second of the “big four” banks, operating in Kazakhstan – JSC “Commercial and Industrial Bank of China in Almaty” – has been operating in Kazakhstan since 1993. It is a

subsidiary of the Industrial and Commercial Bank of China (ICBC).

ICBC has an extensive network of branches and representative offices, both in China and in other countries, and now the number of representative offices of this bank is about 17 thousand (<https://www.zakon.kz/4885169-v-natsbanke-rk-rasskazalio-situatsii-v.html>). But at the moment the bank has no branches in other regions of Kazakhstan. The financial performance of Commercial and Industrial Bank of China in Almaty is also quite high, as is the Bank of China in Kazakhstan. So, at the end of April 2017, the bank's assets amounted to 62,500,444 thousand tenge, and its own capital – 11,996,776 thousand tenge. The bank took the 28th place in the rating of Kazakhstan banks in terms of assets and the 27th in terms of capital.

Consequently, today, cooperation of Kazakhstan and China in the banking sector is limited to the participation of two subsidiary banks from the “big four”, but nevertheless, D. Akishev, the former deputy chairman of the National Bank of Kazakhstan, noted that Kazakhstan-China partnership in the financial sector is not limited to this (https://forbes.kz/leader/rejting_bankov_kazahstana_2018_1532941613/). In turn, Kazakhstani banks also entered the Chinese market, in particular, the Halyk Bank of Kazakhstan.

Part of the implementation of the initiative of the Chinese government “One Belt. One Road” in order to expand the horizons of financial and trade and economic cooperation between China and Kazakhstan in April 2018, 50.1% of shares of AltynBank JSC were sold to Chinese CITIC Bank and 9.9% of ShuangweiInvestment (Chinese investment company Shuangway).

In September 2018, China CITIC Bank Corporation Limited and Astana International Financial Center signed a memorandum of strategic cooperation.

As part of the memorandum, it is planned to jointly develop new business areas and products related to the Chinese yuan, including settlement, exchange operations and the organization of bond issues. Provision is made to provide settlement services in Chinese yuan for residents of AIFC by a subsidiary of CITIC Bank in Kazakhstan – JSC Altyn Bank. In addition, Altyn Bank is ready to provide services as a settlement bank and custodian for the stock exchange of the Astana International Financial Center (AIX). It should be noted that CITIC Bank, being an experienced and active direct participant in the cross-border interbank payment system (CIPS), is ready to provide services of indirect participation in this

system for banks registered with the AIFC to speed up and simplify the process of making payments in Chinese yuan. Altyn Bank has already submitted an application for indirect participation in the CIPS system and will provide the corresponding service at the AIFC site. In addition, Altyn Bank will consider the possibility of opening a branch in the territory of the AIFC to serve the resident companies of the AIFC. The parties also agreed to cooperate in organizing specialized events for investors and issuers of securities in order to bring together the financial markets of China and the AIFC, exchange experience and best practices in the field of financial services, improve financial literacy, including organizing seminars for students and entrepreneurs.

Conclusion

We believe that the introduction of Chinese banks in the Kazakh banking system is mandatory, taking into account China's investment activities in Kazakhstan and the development of trade and other relations. The specificity of Chinese banks is that they expect to serve only their projects. At the same time, the one that Kazakhstan's regulator and partner banks will receive in their interaction with Chinese

banks will allow them to more freely navigate the international community. What will allow in the end to solve the problems that now face the banking sector of Kazakhstan.

For banks globally, 2018 could be a pivotal year in accelerating the transformation into more strategically focused, technologically modern, and operationally agile institutions, so that they may remain dominant in a rapidly evolving ecosystem.

This metamorphosis is far from easy as most banks grapple with multiple challenges: complex and diverging regulations, legacy systems, disruptive models and technologies, new competitors, and, last but not least, an often restive customer base with ever-higher expectations.

In this outlook we explore the challenges most banks face in balancing the need to restructure their foundations for the long-term with finding near-term growth.

We do so by identifying six macro themes that should be critical for long-term growth:

1. Customer centricity
2. Regulatory recalibration
3. Technology management
4. Mitigating cyber risk
5. Fintechs and bigtechs
6. Reimagining the workforce.

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