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### **ANALYSIS OF MEASURES OF ANTI-CRISIS REGULATION OF THE KAZAKHSTAN'S BANKING SECTOR**

*The purpose of this paper is to conduct research on the effectiveness of the banking market regulation and the development of some proposals in the field of forming a stable and efficient banking system capable of rationally managing capital flows. An analysis of the practice of prudential regulation of second-tier banks was conducted. Its weaknesses in terms of information disclosure are identified, which allows a formalized approach to meeting the requirements of the regulator. Underestimated risks that form a misconception of the regulator about the state of the banking sector were identified. It was proposed to conduct a parallel assessment of the credit risk's level by the regulator, based on our own motivated judgment, and also as an indicator reflecting the negative impact of macroeconomic shocks, to use not only the capital of banks, but also the level of non-performing loans.*

**Key words:** *banking system, second-tier banks, loans, risks, non-performing loans, regulation, Basel III.*

In previous works [1, 2, 3] we noted that, in the pre-crisis years, the banking system of Kazakhstan was considered one of the best in the CIS. The activity of the regulator has played a significant role in achieving such results [4]. However, the financial crisis revealed shortcomings in the existing model of state regulation of the financial market. Work on improving the banking system of Kazakhstan was carried out in three areas: providing the banking system with liquidity and funding, improving the quality of banks' loan portfolios, improving the regulation of the financial sector in order to increase its sustainability.

The solution to the first problem was carried out through the National Bank interventions in the money and foreign exchange markets, an increase in refinancing volumes, a reduction in the base of reserve obligations and standards for minimum reserve requirements. In 2008, 112.26 billion tenge was allocated from the Samruk-Kazyna National Welfare Fund, which is approximately 1.1% of the total liabilities of second-tier banks. In 2009, more than 922.7 billion tenge was allocated from the fund, of which 308 billion tenge (about 2% of GDP) [5]. The chosen distribution scheme should have had a double effect, help small and

medium-sized businesses (SMEs) and increase the credit activity of banks. In fact, in recent years there has been an increase to the volume of lending to SMEs until 2016, according to the National Bank of the Republic of Kazakhstan (NBK), the growth of loans only to small businesses was 51%, and as of January 1, 2018 - 34.3% (or 4665 billion tenge), as of December 1, 2018. - the share was only 33.6% (or 4 520 billion tenge). The structure of lending to SMEs by sectors of the economy indicates a persistence of imbalances in lending to the economy, and consequently an inefficient distribution of funds.

The second problem is the low quality of the loan portfolios of banks, which is reflected in the increase in the share of problem loans (loans with overdue payments over 90 days). This is the result of the financial insolvency of the borrower, or the borrower's evasion from repaying the loan [6]. In order to reduce the level of non-performing loans in November 2008, the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations approved the Rules for the application of early response measures and methods for determining factors affecting the deterioration of the financial situation of a second-tier bank (Instruction No. 200) [7]. In practice, solving problems with toxic loans was more formal. The most popular ways to "clean up" the loan portfolio were: 1) carrying out the restructuring of problem loans, after revising and changing the initial conditions of the loan agreement, for example, extending the loan terms or providing "holidays" to the borrower, this loan could be attributed to the standard loan group 2) temporary transfer of a pool of loans with overdue over 90 days to collection companies under a cession agreement. In 2012-2013 The National Bank established a limit on the share of loans with overdue principal and (or) accrued interest over ninety days in the total volume of the bank's loan portfolio not more than 20%, and from 2014 onwards. no more than 15%. According to the NBK, in 2013-2014, there was an increase in toxic loans in large and medium-sized banks with high credit activity. In general, the decline in the level of problem loans, according to the NBK, was due to: under the influence of the tenge exchange rate adjustments, non-performing loans increased by 9.9%; reduction of NPL by 51.6%, as a result of the interconnected work of the regulator with second-tier banks in reducing problem loans; the emergence of new problem loans caused a growth of 22.1% [5]. In addition to the development of measures to identify the factors of increasing credit risk, in 2012, schemes were developed and implemented to improve the loan portfolios of banks through the sale of a pool of toxic loans to JSC «Problem Loan Fund». In the part of loans for which the probability of repayment was extremely low, conditions for forgiving debt were introduced without incurring additional tax liabilities for the bank. In 2014, the National Bank of Kazakhstan established the Commission for the Evaluation and Control of Overdue Loan Reduction Activities [8]. The regulator has taken a number of measures to rationalize legislation regarding taxation of banks, as well as removing administrative restrictions that generally contribute to activating banks in solving problems with toxic loans [5].

Taking into account all these activities done by the National Bank from January 1, 2016, the maximum limit for non-performing loans was reduced to less than 10% of the loan portfolio. The banking sector of the Republic of Kazakhstan as of October 1, 2018 is represented by 28 second-tier banks (STB), decreasing by 4 compared with the beginning of the year. Of these, 14 are banks with foreign participation in the capital. The bank's assets amounted to KZT 24,539 billion (42.1% of GDP), including the loan portfolio amounted to

more than 50% or KZT 13,194 billion. Non-performing loans over 90 days overdue (NPL) amounted to more than 1,123 billion tenge or 8.5% of the loan portfolio. Regulatory capital has developed in the amount of 3 666.8 billion tenge or 14.9%. Banking sector revenues amounted to more than 506 billion tenge, ROA - 2.35%, ROE - 19.01%. The dynamic development of the economy of Kazakhstan in the pre-crisis period required corresponding changes in the banking system (Table 1).

**Table 1** – Indicators of the banking sector of the Republic of Kazakhstan for 2000-2018.

At the end of the year	Assets			Loans			Deposits		
	billion tenge	growth rate, %	in% of GDP	billion tenge	growth rate, %	in% of GDP	billion tenge	growth rate, %	in% of GDP
2000	528	154,8	20,3	273	176,4	10	319,6	122,1	12,2
2001	818	154,9	25,2	649	237,7	20	438	143,1	13,5
2002	1 145	140	30,3	717	110,6	19	576	131,6	15,3
2003	1 676	146,4	36,3	1 087	151,5	23,6	731	126,9	15,9
2004	2 690	160,5	45,8	1 629	149,9	27,7	1 255	171,7	21,4
2005	4 515	167,9	59,5	3 062	188	40,3	2 523	201	33,2
2006	8 875	196,6	86,9	5 992	195,7	58,7	4 715	186,9	46,2
2007	11 685	131,7	90,9	8 868	148	69	6 424	136,2	50
2008	11 890	101,8	74,1	9 245	104,2	57,6	6 873	107	42,8
2009	11 557	97,2	68	9 639	104,3	56,7	7 799	113,5	45,9
2010	12 031	104,1	55,2	9 066	94,1	41,6	6 851	87,8	31,4
2011	12 818	106,5	45,4	10 473	115,5	37,1	7 799	113,8	27,6
2012	13 880	108,3	44,8	11 658	111,3	37,6	8 533	109,4	27,5
2013	15 462	111,4	43	13 348	114,5	37,1	9 846	115,4	27,3
2014	18 239	118	46	14 184	106,3	35,8	11 351	115,3	28,6
2015	23 780	130,4	58,2	15 554	109,7	38	15 605	137,5	38,2
2016	25 557	107,5	54,4	15 511	99,7	33,0	17 269	110,6	36,8
2017	24 158	94,5	46,5	13 591	87,6	26,2	16 681	96,6	40,7
01.10.2018	24 539	101,6	42,1	13 194	97,1	22,7	16 639	99,7	28,6
Note. The table is compiled by the authors of the source [2].									

As can be seen from the table, in 2005-2007, the total assets of second-tier banks increased from 59.5% of GDP to 91% of GDP, and in 2000 the banking sector was only 20% of GDP. The deposit portfolio of banks grew by an average of 57% over the year, and by the end of 2007 it was 50% of GDP. The loan portfolio of banks grew at a higher rate, on average, lending increased by 68% over the year over the period 2001-2007. Funding of the banking business from foreign sources was carried out against the background of growing lending activity of foreign banks, an excess of inexpensive resources, and a low level of interest rates.

In our opinion, the actual level of non-performing loans is much higher than official value. Thus, the statistical data of the National Bank is based on the financial statements of the STB, and the market is characterized by asymmetric information. The ability of banks to distort financial statements in order to conceal the real state of the quality of their assets is one of the important problems in the current system of regulation and supervision [9].

Tightening the requirements of the regulator leads to a greater concealment of negative trends in the activities of the bank. The recognition by the bank of the presence of a large proportion of low-quality assets, first of all, requires the formation of the volume of reserves corresponding to potential risks. In the face of increasing requirements for capital adequacy, banks are more inclined to conceal information than to provide true values. In view of the fact that the financial statements of the STB of the Republic of Kazakhstan, which do not reflect the true state of affairs, in our opinion, first of all, reduces the effectiveness of the regulatory measures taken by the National Bank, secondly leads to the formation of new risks within the banking sector, and in the economy as a whole.

In order to solve the third problem, the regulator introduced a number of changes to the regulatory framework governing the activities of financial institutions. There has been a shift in focus from micro-prudential to macroprudential regulation of the financial sector. The main instrument for the introduction of macro-prudential regulation of the banking sector is the international standards of banking supervision - Basel II, countercyclical regulation - Basel III. Basel standards contain minimum requirements for banks, and are advisory in nature. In practice, central banks put higher demands on the bank in order to ensure its resistance to various kinds of shocks [10, 11].

We are interested in: how effective will the implementation of the principles of the Basel Accords be in the practice of domestic banking supervision; as far as they are applicable to the conditions of the domestic economy. The latest agreement of the Basel Committee on Banking Supervision recommends increasing the requirements for the quality and capital structure of a bank by removing elements from it that do not meet the established requirements, increasing the minimum value of the capital requirements, and minimizing pro-cyclical regulation by creating additional capital buffers [12]. In 2012, the National Bank developed and agreed with the STB a schedule for introducing the transition to international capital standards, with the phased implementation of standards from January 2014 to January 2019. The latest changes in the schedule of transition to international standards of capital regulation were made in 2016. The second component of Basel III, International Approaches to Measuring Liquidity Risk, Standards and Monitoring, complements stricter requirements for the structure and quality of capital and minimal requirements for maintaining liquidity by introducing prudential standards into the system of short-term liquidity and net stable funding. Starting from 2016, second-tier banks on the basis of monitoring conditions, calculate these indicators. As a prudential requirement, the short-term liquidity ratio should be introduced in the second half of 2017 with an initial value of 60, a target value of 100 is planned to be achieved by 2021. [13]. The positive effect of these measures is possible, in case of identifying all the risks to which the banking sector is exposed. The previous Basel II agreement expanded the risk base (weighting of assets takes into account three types of risks: credit, market and operational).

An alternative is the IRB approach based on the use of the bank's internal ratings in determining the borrower's creditworthiness. The calculation of risk is based on a mathematical model with the inclusion of four variables: the probability of the bankruptcy of the borrower (PD); share of losses in case of counterparty bankruptcy (LGD); loss expressed in monetary unit (EAD), the balance of the loan obligation (M). On the basis of this model, the values of expected (EL) and unexpected (UL) losses are calculated, subsequently used in the calculation of capital adequacy [14]. The implementation of these methods for assessing credit risk in practice did not bring the expected effect.

Improving early response measures includes the National Bank conducting stress testing of the banking sector for its resistance to external and internal shocks [15]. The concept of stress testing has a positive effect, but the use of managerial rather than financial statements of second-tier banks will bring more results.

Thus, the measures taken by the regulator ultimately lose their effectiveness. One of the main problems, in our opinion, which is an obstacle to the improvement of the current system of regulation and supervision is the absence in the banking legislation of the rules providing for liability (penalties) of the organizations of the banking sector in case of violation of information disclosure requirements. The post-crisis concept adopted in almost all countries - regulation at the macro level, taking into account procyclicality, carried out by a single regulator - in practical application will manifest itself in the direct impact of the mega-regulator on economic development, elimination of imbalances in the structure of the economy, cyclical component.

**Conclusion.** One of the important tasks is to identify banking risks, and the adoption of appropriate measures to reduce their level. The main problem that reduces the effectiveness of the measures taken by the supervisory authority is the lack of prudential discipline of banking institutions, which is expressed in violation of information transparency standards. In fact, a number of activities carried out by the National Bank to reduce the level of problem loans in the banking sector brought a positive result, according to official statistics, however, unconfirmed by the real improvement in the quality of loan portfolios. Meeting the requirements of the regulator, was mostly of a formal nature.

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## **АНАЛИЗ МЕР АНТИКРИЗИСНОГО РЕГУЛИРОВАНИЯ БАНКОВСКОГО СЕКТОРА КАЗАХСТАНА**

*Цель работы – провести исследования эффективности регулирования банковского рынка и выработка некоторых предложений в сфере формирования устойчивой и эффективной банковской системы, способной рационально управлять потоками капитала. Проведен анализ практики пруденциального регулирования банков второго уровня, выявлены ее слабые стороны в части раскрытия информации, что допускает формализованный подход к выполнению требований регулятора. Идентифицированы недооцененные риски, которые формируют неправильное представление регулятора о состоянии банковского сектора. Предложено проведение параллельной оценки уровня кредитного риска регулятором, на основе собственного мотивированного суждения, а*



также в качестве индикатора, отражающего негативное влияние макроэкономических шоков, использовать не только капитал банков, но также уровень неработающих кредитов.

**Ключевые слова:** банковская система, банки второго уровня, кредиты, риски, неработающие (проблемные) кредиты, регулирование, Базель III.

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## **ҚАЗАҚСТАН БАНК СЕКТОРЫНЫҢ ДАҒДАРЫСҚА ҚАРСЫ РЕТТЕУ ШАРАЛАРЫН ТАЛДАУ**

Жұмыстың мақсаты – банк нарығы реттеуінің тиімділігін көрсететін зерттеулер жүргізу, сонымен қатар капитал ағындарын ұтымды басқаруға қабілетті тұрақты және тиімді банк жүйесін қалыптастыру саласында бірқатар ұсыныстар әзірлеу. Екінші деңгейлі банктерді пруденциалдық реттеу тәжірибесіне талдау жүргізілді, сонымен қатар реттеушінің талаптарын орындауға формальды көзқарас жіберетін, ақпаратты ашатын оның әлсіз жақтары анықталды. Банк секторы ахуалы туралы реттеушінің қате түсінігін қалыптастыратын бағаланбаған тәуекелдер теңдестірілген. Авторлар пікіріне негізделген, реттеушінің кредиттік тәуекел деңгейінің параллельді бағалауы, сонымен қатар макроэкономикалық сілкіністердің жағымсыз әсерін көрсететін индикатор ретінде банк капиталымен қатар жұмыс істемейтін несиелерін де пайдалануы ұсынылды.

**Түйін сөздер:** банк жүйесі, екінші деңгейлі банктер, тәуекелдер, жұмыс жасамайтын (проблемалық) несиелер, реттеу, Базель III.