

ISLAMIC FINANCE MASTER PLAN FOR THE REPUBLIC OF KAZAKHSTAN 2020-2025



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ISLAMIC FINANCE MASTER PLAN FOR THE REPUBLIC OF KAZAKHSTAN 2020-2025

Nur-Sultan, 2020

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FOREWORD

It is a pleasure for me to introduce Islamic Finance Master Plan for the Republic of Kazakhstan prepared under the Technical Assistance of the Islamic Development Bank.

Islamic Finance industry plays an important role contributing to the real economy and enhancing stability of the global financial system. Creating sound financial system is identified as one of the important tasks fostering Kazakhstan's development.

In 2015 the First President of the Republic of Kazakhstan Nursultan Nazarbayev announced one of his farsighted strategic initiatives - the establishment of the International Financial Centre in the capital of Kazakhstan.

AIFC is a modern financial hub for the countries of Central Asia, Eurasian Economic Union, the Caucasus, Mongolia, Western China and Eastern Europe. The aim of the Astana International Financial Centre is to support sustainable economic growth and foster the development of financial services. We focus on several strategic pillars such as capital markets, asset management, private banking, financial technology, green and Islamic finance.

Since inception, we have invested a significant amount of time and effort to create best in the class financial centre with a most compelling ecosystem. AIFC's fundamentals lie within a top-notch legal and regulatory regime, tax exemption for 50 years, simplified currency, visa and labour regimes for AIFC participants. Creation of favorable conditions for the functioning and development of Islamic finance entities is one of the main directions for the development of the AIFC.

Islamic finance has a huge potential for development in the region. Since the potential market for Shari'ah-compliant services in the Eurasian region is affected not only by large underserved Muslim populations, but also a direct link between Islamic finance and real economy.

The Master Plan provides a vision and template in developing the Islamic financial services industry in AIFC and Kazakhstan. It provides the sequencing of priorities and identifies the key infrastructure that needs to be put in place before advancing forward. Through a complete understanding of challenges and opportunities it forms a basis for Islamic finance development planning.

Given today's global disruptions, people and companies will change the way they conduct their business. This will give an impetus for an accelerated digital transition including digitalisation of trade and services. In facing the current economic challenges and the uncertainty surrounding what is becoming the newer normal, we are committed to build the foundation for stronger future growth and prosperity.

The ultimate goal is to enhance wealth creation and promote sustainable and balanced economic growth. The vision is, therefore, to develop a progressive and robust Islamic banking and financial system that best serves the needs of our economy.

Dr. Kairat Kelimbetov
Governor, AIFC
(IsDB Governor for Kazakhstan)

FOREWORD

Kazakhstan has built up a well-earned reputation as a regional leader, thanks to its years-long political stability and the strong commitment to economic liberalisation backed by immense stocks of natural resources. The achievements of the past have well prepared the country to face the current global economic challenges with confidence and the ability to pursue long-term sustainable growth. I am confident that Kazakhstan will maintain its leading position at the regional and global levels.

Kazakhstan has always been at the forefront of innovation and structural reform. The establishment of the Astana International Financial Centre (AIFC), on the basis of a sound legal framework with a special focus on Islamic finance, is another manifestation of the strong commitment of AIFC management and the political will of the Government of Kazakhstan.

The country has the key requirements to not only establish a thriving local Islamic finance market, but also position itself as a regional hub for Islamic finance in Central Asia and the CIS region. Kazakhstan has positive economic outlook, strong domestic demand, strategic geographic location and large Muslim population. All these factors coupled with strong government support and the legislative regime introduced to support Islamic finance will facilitate the growth of this industry in the country as well as the whole region.

The Islamic Development Bank (IsDB) is committed to the development of the global Islamic finance industry and it has a department dedicated for Islamic financial sector development backed by a special allocation to support Islamic finance initiatives across the world.

The IsDB takes pride in supporting the development of Islamic finance industry in the Republic of Kazakhstan. The Bank has played an indispensable role in the development of the AIFC Master Plan 2020-2025, which will further boost Islamic banking and finance industry in the country. The plan will allow for wider scope of cooperation between IsDB Group entities and Islamic banks, Islamic insurance companies and Islamic capital markets in Kazakhstan in the all-encompassing relevant areas including Islamic social finance, halal industry, Islamic fintech and others.

The Master Plan will provide the necessary impetus for further development of the industry. I am confident that given the strong political will and the tangible measures taken to implement the Master Plan, the Islamic finance industry will grow in a steady and sustainable manner. I have no doubt that the growth of Islamic finance industry in Kazakhstan in the coming decade will be the springboard for a wider growth at the regional and global levels.

Dr. Bandar M. H. Hajjar
President, Islamic Development Bank Group

EXECUTIVE SUMMARY

ISLAMIC FINANCE MASTER PLAN FOR THE REPUBLIC OF KAZAKHSTAN 2020-2025

The government of Kazakhstan has set its sights to be amongst the Top 30 advanced economies by 2050. To realize this vision, the government aims to reduce the state's financial footprint and foster economic diversification. These efforts will represent a transition from substantial state support in recent years towards a market-driven economy, with a focus on attracting more foreign investments into the non-oil sectors.

These efforts will be reinforced by strengthening the government's key infrastructure, and this includes making public administration more service-oriented and efficient, improving the business environment, investing in enabling infrastructure such as transportation and information technology (IT), and undertaking Public-Private-Partnerships (PPPs). To improve the mobilisation of long-term capital into the economy, strengthening the financial system and its architecture is a vital step. In this respect, a strengthening of the Islamic finance industry in Kazakhstan will not only broaden its financial system but will also contribute towards financial stability and become a potent force in its drive to foster greater economic diversification and promote sustainable economic development.

The Islamic finance industry is already mainstreamed within the global financial system and rapidly growing especially in Muslim-majority countries. Advanced financial markets such as the United Kingdom, Luxembourg, South Africa and Hong Kong have all embraced Islamic finance. Over the last few decades, Islamic finance has progressed at a rapid pace globally growing at a rate of 10-12% on average annually. The value of Islamic financial assets globally is estimated at US\$2.19 trillion as of the year 2018 (Islamic Financial Services Board ("IFSB"), 2019)¹. In parallel, the global Muslim population has increased to approximately 1.8 billion². According to the Pew Research Center, a nonpartisan American fact tank, these 1.8 billion Muslims representing roughly 24% of the global population are expected to reach 2.76 billion (representing 29.7% of the global population) by 2050. This rapid growth of the Muslim population reflects the latent demand and underscores the potential for further growth in the Islamic finance industry, as well as the halal economy in general.

As Islamic finance assets surpassed the US\$2 trillion mark and grew 6.8% in 2018, Islamic banking and *Sukuk* outstanding represent 72% and 24%, of the total US\$2.19 billion Islamic finance assets respectively. The GCC region remains the largest Islamic finance market owning about 42% of the total assets, followed by Asia at 28%, and MENA (excluding GCC) at 25%.

The increasing success of Islamic finance and its recognition as an effective tool for financing are based on the perception that Islamic financial institutions operate more ethically and embrace a higher moral standard leading to risk moderation and lower moral hazards. Moreover, Islamic finance is linked to the real sector of the economy since its activities are equity-based and asset-backed/asset-based. It promotes risk sharing, encourages financial inclusion and social welfare. The fundamental principles of Islamic finance, which are designed to promote economic justice, include: (i) the prohibition of charging interest on loan/debt (*riba*), (ii) the prohibition of gambling (*maysir/qimar*), (iii) the prohibition of excessive contractual uncertainty (*gharar*), and (iv) the prohibition of engagement in unethical or immoral activities. These values have proven to contribute to the stability of financial systems globally³.

Strengthening the domestic financial system of Kazakhstan is the key to mobilize the domestic and external liquidity potentially available to Kazakhstan to spur the national economic growth and manage external shocks. Hence, Islamic finance could expectedly broaden the country's avenue for capital formation and investment, promote financial inclusion as well as sustainable and responsible finance. With stronger economic

¹ Islamic Financial Services Board, "Islamic Financial Services Industry Stability Report 2019", p. 10. Retrieved on 31 August 2019, from <https://www.ifsb.org/download.php?id=5231&lang=English&pg=/sec03.php>

² C. Hackett, & D. McClendon, "World's largest religion by population is still Christianity", 2019. Retrieved 17 July 2019, from <https://www.pewresearch.org/fact-tank/2017/04/05/christians-remain-worlds-largest-religious-group-but-they-are-declining-in-europe>

³ H. Askari, N. Krichene, & A. Mirakhor, A, "On the stability of an Islamic financial system", *PSL Quarterly Review*, 67(269), 2014, p. 131-167. Available at SSRN: <https://ssrn.com/abstract=2508177>

fundamentals and a resilient financial sector, Kazakhstan can take advantage of emerging opportunities within the region and worldwide. Hence, it is vital to set up a robust infrastructure which integrates the various components of Islamic finance industry such as Islamic banking, Islamic capital markets, Islamic insurance (*takafu*), Islamic microfinance, and *hala*/sector. It is vital that these components of the Islamic finance industry can be developed at the same time as they are mutually interdependent upon and reinforce each other.

To strengthen the AIFC, which was officially launched in 2018. Islamic finance has been made as one of its growth pillar. The internationalisation of the AIFC's Islamic finance offering multitude of financial and business solutions for the domestic market and the Central Asia region would enhance its competitiveness, vibrancy, expand scale and uplift the standing of the AIFC. In the process, it would support the development and growth of the Islamic finance industry domestically and help establish the AIFC as a leading regional finance hub integrated which is integrated with the global market. These measures are in alignment in particular, with Step 70 of the 'Government of Kazakhstan's '100 Concrete Steps' (**"National Plan"**) which aims to establish the AIFC as one of the top 20 financial centres in the world and Step 71 that calls for a strategy for the AIFC to provide specialized services to the capital markets including Islamic financial services. The Master Plan for Islamic Finance Development (**"Master Plan"**) aims to establish a level playing field for Islamic finance in Kazakhstan and has set a strategic target to grow the Islamic finance industry so that its share of the country's total financial assets increases to up to 3-5% by the year 2025.

To accomplish this objective, the Master Plan has outlined a clear vision to strengthen the development of Islamic finance in domestic Kazakhstan and internationalise the AIFC's Islamic finance. The vision is backed by identification of strategic initiatives, key recommendations and action plans to boost the growth of the industry. The formulation of the Master Plan is guided by sound principles which promote financial inclusion, and sustainable practices with a view to increasing efficiency, and competitiveness as well as expanding scale.

The Master Plan's key strategic initiatives for the development of an integrated Islamic finance infrastructure can be summarized as follows:

I. INTERNATIONALISATION OF THE AIFC

1. Build international Islamic intermediation capabilities;
2. Widen global and regional investor and liquidity base;
3. Expand international connectivity and regulatory linkages;
4. Promote Islamic finance as value-based finance and investments; and
5. Establish the AIFC as a reference point for Islamic finance development, standards and innovation.

II. ISLAMIC BANKING

1. Allow conventional banks in Kazakhstan to operate Islamic windows;
2. Cover Islamic banks under the Deposit Insurance Scheme;
3. Develop an Islamic Finance Department at regulatory/supervisory levels;
4. Lower the entry barrier for new players and product eligibility to add diversity and depth in the market;
5. Review the existing regulatory framework to address gaps and anomalies; and
6. Establish supporting infrastructures to ensure stability and sustainability.

III. ISLAMIC CAPITAL MARKET

1. Promote the development of a viable market for capital formation and effective mobilization of Islamic capital;
2. Facilitate the offering of a diverse and competitive range of Islamic products and services;
3. Facilitate robust development of innovative frameworks for a competitive and dynamic financial landscape;

4. Strengthen competitiveness and efficiency of market institutions;
5. Broaden Islamic intermediary capability and strengthen the competitive environment for Islamic services;
6. Build domestic capacity with linkages across institutions; and
7. Expand the scale of Islamic markets to boost domestic and regional competitiveness.

IV. ISLAMIC INSURANCE (TAKAFUL) AND

1. Review the existing regulatory framework to address gaps and anomalies; and
2. Establishment of soft infrastructures necessary for the *takaful* ecosystem.

V. ISLAMIC NON-BANKING INSTITUTIONS

1. Strengthen the regulatory and supervisory framework for non-banking sector; and
2. Develop adequate infrastructure for Islamic non-banking sector.

VI. ISLAMIC SOCIAL FINANCE

1. Establish and facilitate an enabling environment for a *zakat* and *waqf* ecosystem;
2. Promote *zakat* to support social protection system and financial inclusion;
3. Develop adequate *zakat* infrastructure;
4. Develop a robust *zakat* regulatory framework;
5. Enhance the competencies of the *zakat* collector;
6. Increase public awareness on the importance of *zakat* obligation;
7. Facilitate the offering of diverse *waqf* models;
8. Promote *waqf* as an engine of economic growth;
9. Introduce a specific *waqf* legal framework; and
10. Increase the level of awareness and literacy on importance of *waqf* institution.

VII. FINTECH

1. Strengthen the financial stability and sustainability through the integration of financial institutions and FinTech companies' participations;
2. Preserve the confidentiality and protection of customer's data;
3. Increase the financial inclusion through efficient, cost-effective and innovative financial gateways; and
4. Promote collaboration with international participants.

VIII. HALAL SECTOR

1. Enact a cooperative *halal* assurance scheme for products beyond food and drinks;
2. Introduce a legal framework for the *halal* industry using FinTech as a platform for distribution;
3. Establish a *halal* supply chain through a national *halal* hub;
4. Encourage access to Islamic financing for the production, marketing and distribution of *halal* products;
5. Encourage *halal* education and research in academia;
6. Run a public awareness program on the need for the provision of *halal* products in the country; and
7. Offer education and training on *halal* certification technologies.

IX. ISLAMIC FINANCE EDUCATION AND TRAINING

1. Increase the awareness among the youth and the young professionals on the career potentials of the Islamic finance industry;
2. Foster partnerships between the institution of higher learning institutions with the industry;
3. Upgrade the skills and knowledge of the existing workforce;
4. Create a pool of qualified academicians, trainers and Shari'ah advisers;
5. Increase collaboration with reputable academic and training institutions;
6. Establish a regional centre of excellence and thought leadership; and
7. Establish an AIFC Islamic finance media channel.

These strategic initiatives are mutually reinforcing. They will assist not only the development and growth of Islamic finance in Kazakhstan but more importantly help drive the country's economic growth in a way that is inclusive and sustainable, promote financial stability and achieve the aim of shared prosperity.

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND AND TERMS OF REFERENCE

The Astana International Financial Centre (“AIFC”) has, pursuant to the Agreement for Consultancy Services dated 11th July 2019 (“Consultancy Agreement”), under Technical Assistance of the Islamic Development Bank appointed ZICO Shariah Advisory Services Sdn. Bhd. to assist in:

- (i) developing a detailed recommendations for the development of Islamic banking and finance sector in the Republic of Kazakhstan and the AIFC; and
- (ii) building the AIFC’s internal capacity to manage and execute the Master Plan.

Our scope of services and terms of reference are to:

1. Conduct market research on the existing state, challenges and obstacles for the development of the Islamic banking and finance industry in the Republic of Kazakhstan and the AIFC and to identify growth potential areas for the industry.
2. Develop a detailed Master Plan for the development of the Islamic banking and finance industry in the Republic of Kazakhstan, with detailed action plans, implementation steps, monitoring mechanisms and impact evaluation process for each milestone. The Master Plan should include the following:
 - Islamic banks, including full-fledged Islamic banks, Islamic subsidiaries, branches, windows of conventional banks, interbank money market either international or domestic;
 - Islamic non-bank financial institutions, Islamic finance companies, Islamic microfinance institutions, credit sale subsidiaries of trading companies and other similar institutions, as well as institutions managing *hajj* funds and inheritance;
 - Islamic insurance (*takaful*) whether family or general insurance/*takaful*, Islamic reinsurance (*re-takaful*), *takaful* participant funds, *takaful* operators, brokers, Islamic windows;
 - Islamic capital markets such as the equity market, *Sukuk* market, crowdfunding market including Islamic private equity (“PE”)/venture capital (“VC”) and their players, as well as Islamic fund and wealth management institutions;
 - Shari’ah social finance such as *waqf*, *zakat*, and *sadaqah* management institutions;
 - Islamic finance capacity building such as professional accreditation, education and training via centres and universities;
 - Internationalisation of Islamic finance (the AIFC as an effective Islamic international financial centre) via linkages, connectivity, collaboration and distributions;
 - FinTech such as cryptocurrency, robo-advisory and machine learning;
 - Real *halal* industry: integration with Islamic finance of other industries such as the food, tourism, pharmaceuticals, cosmetics, and media;
 - Sustainable and responsible investments (“SRI”): value based intermediation; and
 - Other sections.
3. Laying out the foundations of the Islamic financial ecosystem and enabling environment (the legal and regulatory framework, accounting and taxation, human talent, governance) based on the guiding principles of leadership, competitiveness, scale, internationalization, efficiency, inclusiveness, sustainability and impact.
4. Conduct two workshops to build capacity at the AIFC and Kazakhstan in order to understand and appreciate Islamic finance alongside the presentation of the final version of the Master Plan.

1.2 METHODOLOGY AND CONSULTATION PROCESS

Our methodology of choice in the development of this Master Plan follows a standard twin model of data reliance: (i) primary data gathering from specific focus group discussion meetings within Kazakhstan (“**Primary Data Group**”); and (ii) utilisation and references to secondary analytical data and statistics as publicly available or as availed to us by the AIFC and the various stakeholders of Islamic finance in Kazakhstan which includes the National Bank of Kazakhstan (“**NBK**”), the Development Bank of Kazakhstan (“**DBK**”), Halyk Finance, etc. The breakdown of our data sources are as follows:

PRIMARY DATA GROUP

Our Primary Data Group consists of three face-to-face Focus Group Discussion (“**FGD**”) meetings within Kazakhstan and is supplemented with various stand-alone FGD meetings held either via face-to-face meetings in Kuala Lumpur or via conference telephonic communication. The summary of our FGD meetings can be found in Appendix 1.

1.3 THE FRAMEWORK OF THE MASTER PLAN REPORT

The formulation of this Master Plan comes at a key moment in the global economy and domestic economy of Kazakhstan. With the level of uncertainty reaching ever greater heights, Kazakhstan and the region must take action to adjust to the possible long-term consequences that will emerge at the end of this uncertainty period. In this context, the deepening and expansion of the market along with the growth of the private sector is necessary to face the challenges of this uncertain global landscape and support the national transformation process.

The Master plan has been prepared by IsDB Consultants and should not be considered as a binding document, but rather a consolidated brief of recommended initiatives for implementation. The stakeholders listed were proposed as per their potential interest in related activities. This Master Plan outlines the strategies and recommendations that seeks to transform the competitive dynamics of Kazakhstan through Islamic finance over the next five years. This Master Plan will outline key structural challenges, linkages, and growth opportunities to foster a more diverse and innovative financial environment for the growth of Kazakhstan.

This Master Plan will be divided into the following chapters as identified by our scope of services and its role in the paramount objective of Islamic economic development for the betterment of Kazakhstan and the region:

▪ **CHAPTER 2: ISLAMIC FINANCE LANDSCAPE IN KAZAKHSTAN**

This chapter seeks to give an overview of the current ecosystem available for Islamic finance in Kazakhstan and the AIFC.

▪ **CHAPTER 3: VISION AND ASPIRATIONS**

This chapter shall lay out the vision of Kazakhstan and the AIFC. This chapter shall form the guiding principle for this Master Plan, lay out the specific aims of this Master Plan and how the ecosystem of Islamic finance in both Kazakhstan and the AIFC is expected to grow with the strategic initiatives as recommended herein.

▪ **CHAPTER 4: THE AIFC AND THE INTERNATIONALISATION OF ISLAMIC FINANCE**

This chapter discusses the potential and the challenges of the AIFC relative to its position and surrounding ecosystem to be the regional hub for Islamic finance. It analyses the internal strengths and weaknesses of the AIFC’s current operational framework along with possible external threats to the AIFC’s aspirations, namely the upcoming competition it might face.

▪ **CHAPTER 5: ISLAMIC BANKING**

This chapter analyses the current Islamic banking ecosystem in Kazakhstan and how it can be improved upon. The strategic thrust of the recommendations is that by encouraging and strengthening Islamic

banking development in Kazakhstan, the market in the AIFC would be a natural expansion point for domestic Islamic banks who would then be in a better position to service the AIFC's market.

▪ **CHAPTER 6: ISLAMIC CAPITAL MARKET**

This chapter discusses on the state and development of the capital market and Islamic capital market in both Kazakhstan and the AIFC by looking at the Astana International Exchange ("AIX") and the Kazakhstan Stock Exchange ("KASE"). The chapter shall highlight the various gaps which currently impedes capital market participation and growth and recommends the relevant initiatives to not only deepen the market depth but also fosters participation.

▪ **CHAPTER 7: ISLAMIC INSURANCE (TAKAFUL) AND (RE-TAKAFUL)**

This chapter assess the encumbrances which led to the disappearance of *takaful* in Kazakhstan and the revival initiatives while analysing *takaful's* position in the AIFC.

▪ **CHAPTER 8: ISLAMIC NON-BANK FINANCIAL INSTITUTIONS**

This chapter looks at the alternative financial institutions that functions as a means to cover non-traditional financing areas which carries with it great potential and contribute to the overall growth of Islamic finance in both Kazakhstan and the AIFC.

▪ **CHAPTER 9: ISLAMIC SOCIAL FINANCE**

This chapter examines the current status of the social finance structures that are present in Kazakhstan and how the AIFC can be a vehicle to spur its growth within the nation and the region. The proposed initiatives of Islamic social finance prioritise the expansion in the understanding of the Islamic social finance structures and how it can lead towards greater financial inclusivity.

▪ **CHAPTER 10: FINANCIAL TECHNOLOGY (FINTECH)**

This chapter analyses the current FinTech development in Kazakhstan and AIFC and recommends on the technological leap-frog capability that can be implemented through the integration of new technology and possibly to incubate local FinTech development in the AIFC. FinTech is a leverage on the vision and mission of putting the AIFC as an engine and driver of prosperity throughout Kazakhstan and the region.

▪ **CHAPTER 11: HALAL SECTOR**

This chapter seeks to bring to light the real economy potential of Kazakhstan and bring out new potential growth areas not just for the nation but also for the advancement of Islamic finance. The strategic initiatives seek to not only harmonize the real economy of Kazakhstan with the global *halal* economy but also to lay the foundation for entrepreneurial growth in Kazakhstan.

▪ **CHAPTER 12: ISLAMIC FINANCE EDUCATION AND TRAINING**

This chapter discusses the human capital necessary for the development of all the other drivers and sectors in relation to Islamic finance as mentioned above. The development of the human element plays a vital role not just to develop Islamic finance in Kazakhstan but to look outwards on how Kazakhstan's capabilities may in the future be exported and benefit global developmental initiatives.

▪ **CHAPTER 13: IMPLEMENTATION PLAN**

This chapter summarizes all of the strategic initiatives and the working programs of this Master Plan in a holistic view of the grand strategy and how each individual initiative can link and support one another.

CHAPTER 2: ISLAMIC FINANCE LANDSCAPE IN KAZAKHSTAN

2.1 THE REPUBLIC OF KAZAKHSTAN

Kazakhstan is the 9th largest country in the world, situated in Central Asia on the crossroads of Europe and Asia. It is a landlocked country with an isolated geographical position having no direct access to the ocean. In 2020, Kazakhstan had an estimated population of 18.7 million. Islam is the largest religion in the country, constituting up to 70% of the population, followed by 26% of Christianity population.

The economy of Kazakhstan is the largest in Central Asia supported by vast hydrocarbon reserves, minerals and metals. The economy's GDP comprises of agriculture - 5%, industry - 34% and services - 61%. In recent years, economic growth of the country has been induced mainly by high commodity prices and expansion of the extractive sector, which contributed to the increase in consumption and government expenditure. Exports of Kazakhstan depend mainly on primary commodities, therefore the volatility of commodity prices in international markets makes the economy vulnerable. The government of Kazakhstan has stated that one of its priorities is diversification of the economy via supporting the private sector development and improving access to finance, which would expectedly lessen its dependence on commodity exports. *Table 1* presents the key facts on Kazakhstan covering geography, demographics and economy.

TABLE 1: KEY FACTS ABOUT KAZAKHSTAN (AS OF THE YEAR 2020)

Category	Description
GEOGRAPHY	<ul style="list-style-type: none"> ▪ Kazakhstan borders with five countries: Russia, China, Kyrgyzstan, Turkmenistan and Uzbekistan. ▪ Land boundaries: 13,364 km. ▪ Kazakhstan has 2.7 million square kilometres of land area, 1.23% of which is covered by forest. ▪ Among the Organisation of Islamic Cooperation (“OIC”) member countries, Kazakhstan has the largest agriculture areas having nearly 217 million hectares accounting for 15.78% of OIC’s overall 1,375 million hectares. ▪ Kazakhstan has 29 million hectares of arable land accounting for about 9.35% of OIC’s 310 million hectares. ▪ Kazakhstan has abundant natural resources with major deposits of petroleum, natural gas, coal, iron ore, manganese, chrome ore, nickel, cobalt, copper, molybdenum, lead, zinc, bauxite, gold and uranium. ▪ Kazakhstan has the longest rail lines in OIC with 15.5 thousand kilometres.
DEMOGRAPHICS	<ul style="list-style-type: none"> ▪ Kazakhstan’s estimated population: 18.7 million. ▪ Muslims comprise 70% of the population, and 26% are Christians. ▪ Annual population growth rate: 1.21%. ▪ Life expectancy: 73.9 years. ▪ Fertility rate: 2.73 births per woman. ▪ Density: 6.68 persons per square kilometre. ▪ 28% of the total population is below 14 years old, 65% is between ages 15-64, and 7% is above 65 years old. ▪ 57,7% of the population is urban.
ECONOMY	<ul style="list-style-type: none"> ▪ Local currency: Kazakhstan Tenge (KZT). ▪ Kazakhstan is the upper-middle-income economy. In 2019, the nominal GDP was US\$168.5 billion, with GDP per capita US\$11.16 thousand (current international PPP US\$24.74 thousand). ▪ GDP growth rate: 4.5%⁴. ▪ Inflation rate: 5.4%⁵.

⁴ Available at <https://www.adb.org/countries/kazakhstan/economy>

⁵ The annual inflation rate is 5.4% as of July 2019 according to Mr. Yerbolat Dossayev, the Chairman of National Bank of Kazakhstan. “Kazakh GDP grows 4.2 percent January to July”, *The Astana Times*. Available at <https://astanatimes.com/2019/08/kazakh-gdp-grows-4-2-percent-january-to-july/>

	<ul style="list-style-type: none"> ▪ Unemployment rate: 4.8%. ▪ International reserves: US\$29.9 billion. ▪ Kazakhstan is the 12th largest crude oil producer (1.6 million barrels per day, about 4.5% of OIC's total production). Top producers are Saudi Arabia, Iraq, Iran, the United Arab Emirates ("UAE"), Kuwait, Nigeria, and Kazakhstan. ▪ Kazakhstan is the 7th largest cereal producer among the OIC countries (20.4 million tons of cereals). ▪ Kazakhstan's main agricultural products are wheat, barley, cotton and rice, with wheat exports being a major source of hard currency. Farmers raise sheep and cattle; livestock products include dairy goods, leather, meat and wool.
Financial Sector	<ul style="list-style-type: none"> ▪ Kazakhstan's banking sector is represented by 28 commercial banks (including 2 full-fledged Islamic banks), of which 14 banks are with foreign participation. ▪ As of March 2020, the total banking assets: KZT26.73 trillion (US\$69.9 billion), and Islamic banking assets: KZT55.5 billion (US\$145.1 billion). ▪ 3 mortgage organizations. ▪ 28 insurance organizations: 20 general and 8 life insurance companies. ▪ 199 micro-financial organizations registered at the ARDFM. ▪ About 50% of deposits are held in foreign currency. ▪ Base rate: 9.5% (April 2020).
International Trade	<ul style="list-style-type: none"> ▪ Kazakhstan is among the 10th largest grain exporters in the world, exporting to more than 70 countries. ▪ Kazakhstan is the 53rd largest export economy and the 63rd largest importer in the world. In 2019, Kazakhstan exported US\$57.7 billion and imported US\$31.4 billion, resulting in a positive trade balance of US\$26.3 billion. ▪ Kazakhstan's top 5 exports are crude oil (45%), refined copper (7%), gas (5%), ferroalloys (5%) and radioactive chemicals (4%). ▪ Kazakhstan's top 5 imports are refined petroleum (3.5%), packaged medicaments (2.5%), broadcasting equipment (2.5%), cars (2%), and valves (1.5%). ▪ Kazakhstan's top 5 export destinations are Italy (19.3%), China (10.3%), the Netherlands (10.2%), Russia (8.2%) and France (6.3%). ▪ Kazakhstan's top 5 import origins are Russia (37.1%), China (16.7%), Germany (5.1%), the United States (4.6%) and Italy (4.6%).
Foreign Direct Investment	<ul style="list-style-type: none"> ▪ Kazakhstan's major share of foreign investment is in the oil and gas, mining, metallurgy and financial sectors. ▪ Between 2005 and 2018, the country attracted foreign direct investments worth US\$289.6 billion. In the year 2018 alone, the gross inflow of direct investment into Kazakhstan from foreign direct investors amounted to US\$24.3 billion, which is 16% more than in the previous year. ▪ Kazakhstan's top 5 leading sources of investment capital are the Netherlands (30%), United State of America (USA) (22%), Switzerland (10%), Russia (6%) and China (6%).

Sources: NBK⁶, SESRIC (2019)⁷, and Thomson Reuters DataStream Database

⁶ National Bank of Kazakhstan, "Direct Investments Statistic According to the Directional Principle", *National Bank of Kazakhstan*. Available at: <https://nationalbank.kz/?docid=469&switch=english>

⁷ SESRIC, *Statistical Yearbook on OIC Member Countries 2018*. Available at: <http://www.sesric.org/files/article/645.pdf>

According to the World Bank's Doing Business 2019 report⁸, Kazakhstan is ranked 28th out of 190 countries for improvements in the business environment, leading the countries in the region such as Russia, Kyrgyzstan, Uzbekistan and Tajikistan (see *Table 2* below). Compared to the previous years, Kazakhstan facilitated starting a business with lesser effort by shortening the time required for the value-added tax registration, which resulted in making trading across borders smoother by bringing out a new electronic customs declaration system. It also cuts down the customs administrative fees and enforcing contracts easier by making judgments at all levels in commercial cases accessible to the public as well as publishing performance measurement reports on local commercial courts.

TABLE 2: WORLD BANK'S EASE OF DOING BUSINESS INDEX WITH SUB-INDICATORS (REGIONAL COMPARISON)

Country	Regional	KAZ		RUS		KYR		TAJ		UZB	
Indicator	Rank	R	S	R	S	R	S	R	S	R	S
Starting a business	4	36	92.96	32	93.04	35	92.97	60	90.70	12	95.79
Dealing with construction permits	2	35	75.77	48	74.61	29	77.10	135	61.26	134	61.37
Getting electricity	3	76	76.79	12	94.00	164	46.01	173	34.74	35	86.05
Registering property	3	18	84.62	12	88.74	8	90.27	91	63.86	71	66.60
Getting credit	3	60	65.00	22	80.00	32	75.00	124	40.00	60	65.00
Protecting minority investors	1	1	85.00	57	61.67	38	66.67	38	66.67	64	60.00
Paying taxes	2	56	79.28	53	79.77	150	56.55	136	61.35	64	76.92
Trading across borders	3	102	70.36	99	71.06	70	80.74	148	59.06	165	49.79
Enforcing contracts	1	4	81.25	18	72.18	131	50.42	61	62.56	41	67.26
Resolving insolvency	1	37	67.83	55	58.61	82	47.62	146	30.90	91	45.21
Ease of doing business	1	28	77.89	31	77.37	70	68.33	126	57.11	76	67.40

Notes: R stands for Ranking; S is for Score. KAZ – Kazakhstan, RUS – Russia, KYR – Kyrgyzstan, TAJ – Tajikistan, UZB – Uzbekistan. Source of data: WB (2019)

According to the Heritage Foundation's 2019 Index of Economic Freedom⁹, Kazakhstan is ranked 59th out of 180 countries and leads the countries in the region (see *Table 3* below). The report suggests that Kazakhstan has recently improved contract enforcements by introducing time quota for court proceedings and enhancing the system for resolution of property disputes.

TABLE 3: INDEX OF ECONOMIC FREEDOM 2019 (REGIONAL COMPARISON)

Country	Regional	Kazakhstan	Russia	Kyrgyzstan	Tajikistan	Uzbekistan
Indicator	Rank	Score	Score	Score	Score	Score
Rule of Law						
Property Rights	1	59.3	52.4	49.9	47.8	49.8
Government Integrity	1	40.3	36.6	27.2	36.4	25.2
Judicial Effectiveness	1	56.1	45.1	27.9	52.1	34.3
Regulatory Efficiency						
Business Freedom	2	73.9	78.4	73.4	67.3	72.5
Labour Freedom	1	86.2	52.5	79.8	49.2	58.7
Monetary Freedom	2	70.9	65.1	74.4	68.5	58.9

⁸ WB, *Doing business 2019 Report*, World Bank Group, 2019. Available at: <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2019>

⁹ Heritage, "2019 Index of Economic Freedom", *Heritage Foundation*. Available at: <https://www.heritage.org/index>

Government Size						
Government Spending	1	83.7	62.3	54.2	64.6	67.4
Tax Burden	2	93.4	89.4	94.1	91.8	91.3
Fiscal Health	5	41.0	86.6	78.4	60.3	98.7
Open Markets						
Trade Freedom	1	80.0	77.8	78.6	73.6	62.6
Investment Freedom	2	50.0	30.0	60.0	25.0	10.0
Financial Freedom	1	50.0	30.0	50.0	30.0	10.0
Overall Score	1	65.4	58.9	62.3	55.6	53.3
Global Rank	---	59	98	79	122	140

Source: Heritage (2019)

Based on the Global Innovation Index 2019 report¹⁰, Kazakhstan is ranked 79th globally and is the 2nd leading innovation economy in the region (see *Table 4* below).

TABLE 4: GLOBAL INNOVATION INDEX 2019¹¹

Country	Regional	KAZ		RUS		KYR		TAJ	
Indicator	Rank	R	S	R	S	R	S	R	S
Institutions	1	49	68.3	74	60.9	92	54.6	122	46.0
Human Capital & Research	2	67	29.8	23	48.3	60	31.7	87	24.0
Infrastructure	2	67	46.1	62	47.1	89	38.8	115	29.8
Market Sophistication	3	69	46.3	61	49.4	36	55.6	86	43.7
Business Sophistication	2	78	28.1	35	40.0	84	26.7	114	22.2
Knowledge & Technology Outputs	3	81	18.2	47	27.1	85	17.3	68	21.4
Creative Outputs	2	102	18.2	72	25.1	122	13.3	103	18.1
Overall Rank & Score	2	79	31.0	46	37.6	90	28.4	100	26.4

Notes: R stands for Ranking, and S is for Score. KAZ – Kazakhstan, RUS – Russia, KYR – Kyrgyzstan, TAJ – Tajikistan. (Uzbekistan is missing in the report). Source: GII (2019).

According to the latest Human Development Report (UNDP, 2019¹²), Kazakhstan is ranked 50th out of 189 countries. It is the only Central Asian economy included among the countries with a very high human development index. Uzbekistan and Turkmenistan are ranked in the next category which is high level of development (109th and 108th, respectively), whereas Kyrgyzstan and Tajikistan are in the average level of development (122nd and 125th, respectively).

The Department of Economics and Social Affairs of the United Nations has recently reported (UN, 2019) the current trends in the global population and the projected changes, according to which the population of Central Asian countries is projected to grow by 15% in year 2030 from current 73.2 million and by 2050 it is expected to reach 100 million (see *Table 5*). The figures suggest that one quarter of the regional population is

¹⁰ GII, *Global Innovation Index 2019: Creating Healthy Lives—The Future of Medical Innovation*, 12th Edition, 2019. Available at: <https://www.globalinnovationindex.org/userfiles/file/reportpdf/gii-full-report-2019.pdf>

¹¹ The institutions pillar captures the institutional framework of an economy, such as political, regulatory, and business environment. The human capital & research measures the level of education, and research & development. The infrastructure measures information and communication technologies (ICTs), general infrastructure, and ecological sustainability. The market sophistication pillar has three sub-pillars structured around market conditions and the total level of transactions, such as access to credit, investment, and trade, market & market scale. The business sophistication assesses how conducive firms are to innovation activity. The knowledge & technology outputs is related to the fruits of inventions and or innovations. The creative outputs measure the role of creativity for innovation – intangible assets, creative goods & services, and online creativity.

¹² UNDP, "Global Human Development Indicators", *United Nations Development Programme*, 2019. Available at: <http://hdr.undp.org/en/countries>

located in Kazakhstan and 45% in Uzbekistan; about 46% of population is below 25 years old, while 6% is above 65 years old; and, on average, half of the population lives in urban areas.

TABLE 5: CURRENT AND PROJECTED POPULATION OF CENTRAL ASIAN COUNTRIES (IN THOUSANDS)

Country	% of Total Population	Mid-Year Population			% of Population – by Age (Mid 2019)			Urban Population %
		2019	2020	2050	<25	>65	25-65	
Kazakhstan	25	18,551	20,639	24,024	41	8	51	57.4
Kyrgyzstan	9	6,416	7,446	9,126	48	5	47	36.4
Tajikistan	13	9,321	11,557	16,208	55	3	42	27.1
Turkmenistan	8	5,942	6,782	7,949	47	5	48	51.6
Uzbekistan	45	32,982	37,418	42,942	45	5	50	50.5
Total	100	73,212	83,843	100,250	46	6	48	48.2

Source: UN (2019)

Hence, all of these indicators suggest that Kazakhstan has a strong potential to lead the region and become the hub for Islamic finance.

2.1.1 ISLAMIC FINANCE DEVELOPMENT IN KAZAKHSTAN

The global Islamic finance industry is recognized as a fast-growing one and an increasingly important part of the global financial system. By the year 2018, the industry's total value of Shari'ah compliant assets has reached US\$2.19 trillion (see *Table 6* below). The major share of Islamic finance assets belongs to Islamic banking institutions (about 72%), followed by *Sukuk* (24%), Islamic funds (2.8%), and *takaful* (1.2%). Many countries around the globe have accepted and adopted special legislation allowing Islamic financial institutions ("IFIs") to operate as an alternative to conventional finance. Unlike conventional finance, Islamic finance builds and regulates its activities based on the principles and philosophy of Islamic legal jurisprudence. The Gulf Cooperation Council ("GCC") region leads the global Islamic finance industry contributing about 42% to its assets, followed by Middle East and North Africa ("MENA") and Asia with almost half trillion contributions by each.

TABLE 6: BREAKDOWN OF THE GLOBAL ISLAMIC FINANCE INDUSTRY BY SECTOR AND REGION (IN US\$B, 2018)

Region	Banking Assets	<i>Sukuk</i> Outstanding	Islamic Funds Assets	<i>Takaful</i> Contributions	Total	Share %
Asia	266.1	323.2	24.2	4.1	617.6	28.2%
GCC	704.8	187.9	22.7	11.7	927.1	42.3%
MENA (ex-GCC)	540.2	0.3	0.1	10.3	550.9	25.1%
Africa (ex-North)	13.2	2.5	1.5	0.01	17.2	0.8%
Others	47.1	16.5	13.1	--	76.7	3.5%
Total	1,571.3	530.4	61.5	27.7	2,190.0	100.00%

Source: IFSB (2019)¹⁵.

¹⁵ IFSB, *Islamic Financial Services Industry Stability Report 2019*. Islamic Financial Services Board. Available at: <https://www.ifsb.org/download.php?id=5231&lang=English&pg=/sec03.php>

Kazakhstan is the first Commonwealth of Independent States (“CIS”) country to open its door for Islamic finance back in the early 1990s¹⁴. In 1992, by the Decree No.5 the First President of the Republic of Kazakhstan Nursultan Nazarbayev, Al Baraka Kazakhstan International Commercial Bank was established which invested \$100 million into the economy of Kazakhstan. A few years later in 1995, Kazakhstan joined the Islamic Development Bank (“IDB”) and in 1997, IDB opened in Almaty its first regional office across Central Asia and CIS. The IDB has been playing a key role in the development of the Islamic finance industry in Kazakhstan by providing technical assistance and contributing to setting up of the Islamic finance infrastructure. In the year 2003, Bank TuranAlem (“BTA”) JSC was the first financial institution in Kazakhstan to offer Islamic finance products in cooperation with the IDB. Some of the industry key milestones in Kazakhstan are presented in *Table 7* below:

TABLE 7: KEY MILESTONES IN THE DEVELOPMENT OF ISLAMIC FINANCE IN KAZAKHSTAN

Period	Key Milestone
2009	<ul style="list-style-type: none"> ▪ Kazakhstan is the first among the CIS countries to adopt a special legal framework for Islamic finance, for example on the organization and activities of Islamic banks and Islamic finance organizations. ▪ The Association of Development of Islamic Finance (“ADIF”) started its operations as a professional organization for the development of the Islamic finance industry in Kazakhstan. ▪ The first brokerage company Fattah Finance JSC started its operations offering Islamic financial products in Kazakhstan.
2010	<ul style="list-style-type: none"> ▪ Al Hilal Islamic JSC, a 100% subsidiary of Al Hilal (UAE), started to operate as a full-fledged Islamic bank under the intergovernmental agreement between Kazakhstan and the UAE. ▪ MIS Takaful, the first Islamic insurance company in Kazakhstan, was established in the form of a mutual insurance society. ▪ To facilitate <i>Sukuk</i> market development and expand the potential domestic originators' list, a set of new amendments to the legislation was adopted.
2011	<ul style="list-style-type: none"> ▪ The Roadmap for Islamic Finance Development in Kazakhstan by 2020 was approved by the government, to create conditions for the stable development of the Islamic finance industry, promote the establishment of new Islamic banks, define the Islamic securities issuers, investors and market participants. ▪ The member Country Partnership Strategy 2012-2014 was signed by the government of Kazakhstan and IDB Group. ▪ The DBK issued the first Malaysian Ringgit - denominated <i>Sukuk</i> (US\$76.7 million). ▪ The NBK became a member of IFSB. ▪ The Fund for Financial Supporting of Agriculture launched the <i>Murabahah</i> Programme for Islamic Microfinance under the agreement between the IDB and the Fund.
2013	<ul style="list-style-type: none"> ▪ Islamic Corporation for the Development of the Private Sector (“ICD”) acquired shares in the capital of local bank Zaman Bank JSC (“Zaman Bank”). Later on, the shareholders of Zaman Bank have converted to become the country’s first retail Islamic bank. ▪ ICD and a group of international and local investors established the first Kazakhstan Ijara Company JSC (“KIC”).
2014	<ul style="list-style-type: none"> ▪ The First President of the Republic of Kazakhstan Nursultan Nazarbayev was awarded the Global Islamic Finance Award (GIFA).

¹⁴ NBK, “Kazakhstan Islamic Finance 2016: A New Frontier for Islamic Finance”, *Islamic Finance Overview*. Available at: <https://nationalbank.kz/?docid=970&switch=english>

	<ul style="list-style-type: none"> ▪ The NBK became an Observer Member of the Accounting and Auditing of Islamic Financial Institutions (“AAOIFI”) and an Observer Member of the International Islamic Financial Market.
2015	<ul style="list-style-type: none"> ▪ The Memorandum of the Long-Term Cooperation between the NBK and ADIF was signed in February. ▪ Relevant legal provisions to facilitate Islamic banking operations and to provide for Islamic insurance and leasing came into force in May 2015. Islamic insurance (<i>takaful</i>) was recognized as a special type of insurance. ▪ Relevant legal provisions are introduced to allow the conversion of conventional banks into Islamic banks. ▪ Constitutional statute of the Republic of Kazakhstan on the establishment of the Astana International Financial Centre, where the Islamic finance is one of the key pillars of AIFC. ▪
2017	<ul style="list-style-type: none"> ▪ The completion of the conversion of Zaman Bank as an Islamic bank and the issuance of a licence by the NBK for carrying out the Islamic banking operations. ▪ Constitutional statute of the Republic of Kazakhstan on the establishment of the Astana International Financial Centre, where the Islamic finance is one of the key pillars of AIFC. ▪ AIFC creates a favourable legal and regulatory environment on Islamic finance. ▪ AIFC becomes a full member of IFSB and AAOIFI.
2018	<ul style="list-style-type: none"> ▪ On 5th July 2018, the AIFC is officially launched, with Islamic finance being one of its main strategic pillars. ▪ AAOIFI opens exam center in AIFC. ▪ AIFC becomes CIBAFI. ▪ The AIFC Advisory Council on Islamic Finance is established.
2019	<ul style="list-style-type: none"> ▪ Hamad Bin Khalifa University and the AIFC opened an Islamic Finance Centre (IFC) at Al-Farabi Kazakh National University (Almaty). ▪ The AIFC Central Shari’ah Advisory Board is established. ▪ INCEIF appoints AIFC as INCEIF’s collaborative partner.
2020	<ul style="list-style-type: none"> ▪ The Islamic Bank Al Rayan (subsidiary of Al Rayan Investment LLC) has received a certificate of registration with the AIFC. ▪ AIX included sukuk issued by the Qatar International Islamic Bank (QIIB) in the official list. The offering has been initially made on London Stock Exchange (LSE) in the amount of US\$500 million.

Sources: NBK¹⁵, Salikhova (2016)¹⁶ and AIFC

According to ICD Thomson Reuters’ Islamic Finance Development Indicator 2019¹⁷, Kazakhstan’s overall score is 17.93, which is above the global average 10.46 (see [Table 8](#) below).

¹⁵ NBK. “Chronicle of the Development of Islamic Finance in Kazakhstan”. Available at: <https://nationalbank.kz/?docid=784&switch=english>

¹⁶ A. Salikhova, “Banking Law and Implementation of Islamic Banking in Kazakhstan”, *Journal of King Abdulaziz University: Islamic Economics*, 2016, p. 29(2). Available at: https://iei.kau.edu.sa/Files/121/Files/153873_29-02-11-Alfiya.pdf

¹⁷ ICDTR, “Islamic Finance Development Indicator”. *ICD Thomson Reuters*, 2019. Available at: <http://www.zawya.com/islamic-finance-development-indicator/#>

TABLE 8: REGIONAL COMPARISON OF IFDI SCORES

Indicator	Global	Regional Rank	KAZ	RUS	KYR	TAJ	TUR	UZB
QD	5.85	1	13.91	0.26	1.01	0.53	0.00	0.20
Knowledge	9.36	1	8.04	3.07	1.10	0.00	0.00	0.36
CSR	8.08	1	4.49	0.00	0.00	0.00	0.00	0.00
Governance	13.01	1	31.45	0.00	22.42	16.67	0.00	0.00
Awareness	15.99	1	31.73	2.38	12.77	15.18	8.47	9.83
Overall	10.46	1	17.93	1.14	7.46	6.48	1.69	2.08

Notes: IFDI overall score is out of 150. QD – Quantitative Development; CSR – Corporate Social Responsibility. KAZ – Kazakhstan, RUS – Russia, KYR – Kyrgyzstan, TAJ – Tajikistan, TUR – Turkmenistan, UZB – Uzbekistan. Source of data: ICDTR

The score also suggests that Kazakhstan leads the economies in the region in terms of development of the Islamic finance industry. However, to accelerate the growth of Islamic finance industry in the country and increase the total Islamic finance assets to at least up to 3-5% of the country's total financial assets by 2025, more strategic initiatives should be undertaken such as amending the laws to address legal gaps and anomalies, issuing sovereign and corporate *Sukuk*, closely linking the industry with the *hala*/sector, attracting foreign Islamic finance intellectuals (both academic and professional) to gain experience, establishing supervisory department at the level of regulatory/supervisory levels, providing tax incentives, developing a pool of local Islamic finance experts and allowing Islamic banks to open windows.

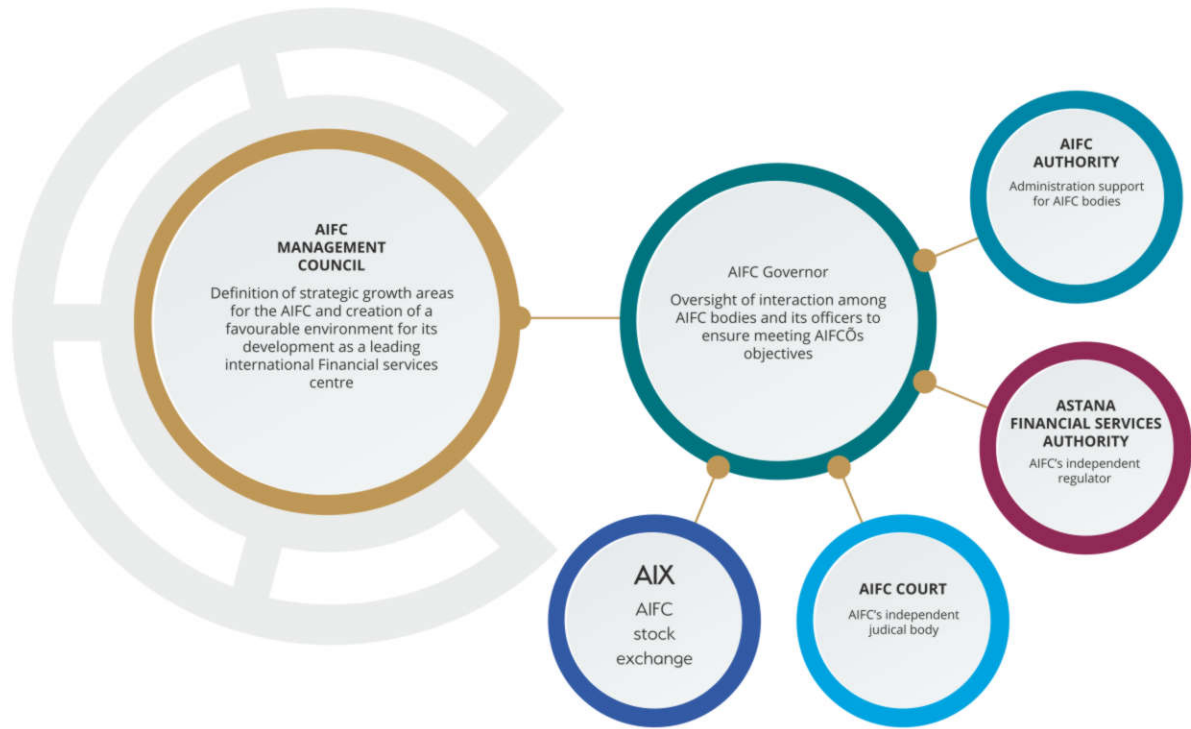
2.2 THE ASTANA INTERNATIONAL FINANCIAL CENTRE

The AIFC is a financial hub in Nur-Sultan, Kazakhstan which was officially launched on 5th July 2018. Geographically, it is a large defined zone within the city of Nur-Sultan wherein the centre's participants may be located at and from there carry on their business activities. The AIFC is ranked the 1st in the region of Eastern Europe and Central Asia, and it is already 51st in the Global Financial Centre Index. Islamic finance is one of core pillars of the AIFC together with capital markets, assets management, FinTech, green finance and private banking. The platform provides such professional services as consulting, auditing, legal, accounting and credit rating.

The existence of the AIFC is premised on the National Plan of the nation dated 20th May 2015 where the First President of the Republic of Kazakhstan Nursultan Nazarbayev announced to implement 5 institutional reforms, designed to provide a strong national platform needed to achieve the country's ambition of joining the top 30 developed countries by 2050. As part of the plan of the nation, the AIFC was established with a special legal status.

The "Constitutional Law on the Astana International Financial Centre" approved on 7th December 2015 provides a legal framework for the functioning of the AIFC as well as a favourable environment for its participants.

2.2.1 ORGANISATIONAL STRUCTURE OF THE AIFC



Other Key Players

AIFC Expat Centre	AIFC Bureau for Continuing Professional Development	AIFC International Arbitration Centre	AIFC Business Connect	AIFC Green Finance Centre	AIFC FinTech Hub
Providing full range of services to foreign employees and their families	Personnel training and implementation of professional standards	AIFC's independent dispute resolution institution	Business development, international outreach and participant support, and encouraging inward investment into Kazakhstan	Ensures development of green finance policy and green financing instruments	Support for start-up projects and companies in IT and financial technologies

2.2.2 THE AIFC'S STRATEGIC OBJECTIVES

The AIFC has set its sights on becoming a regional financial centre and becoming one of the Top 20 leading Asian financial centres within 10 years and will play the role of attracting financial resources. It is positioned as a financial hub for the countries of Central Asia, the Caucasus, Eurasian Economic Union (EAEU), Middle East, Western China, Mongolia and Eastern Europe.

2.2.3 THE AIFC MANAGEMENT COUNCIL

The AIFC management council is a supreme authority that includes high profile leaders of global financial corporations and is chaired by the President of Kazakhstan. The main objectives of the management council include determining the strategic directions for the AIFC's development and assistance in the development of

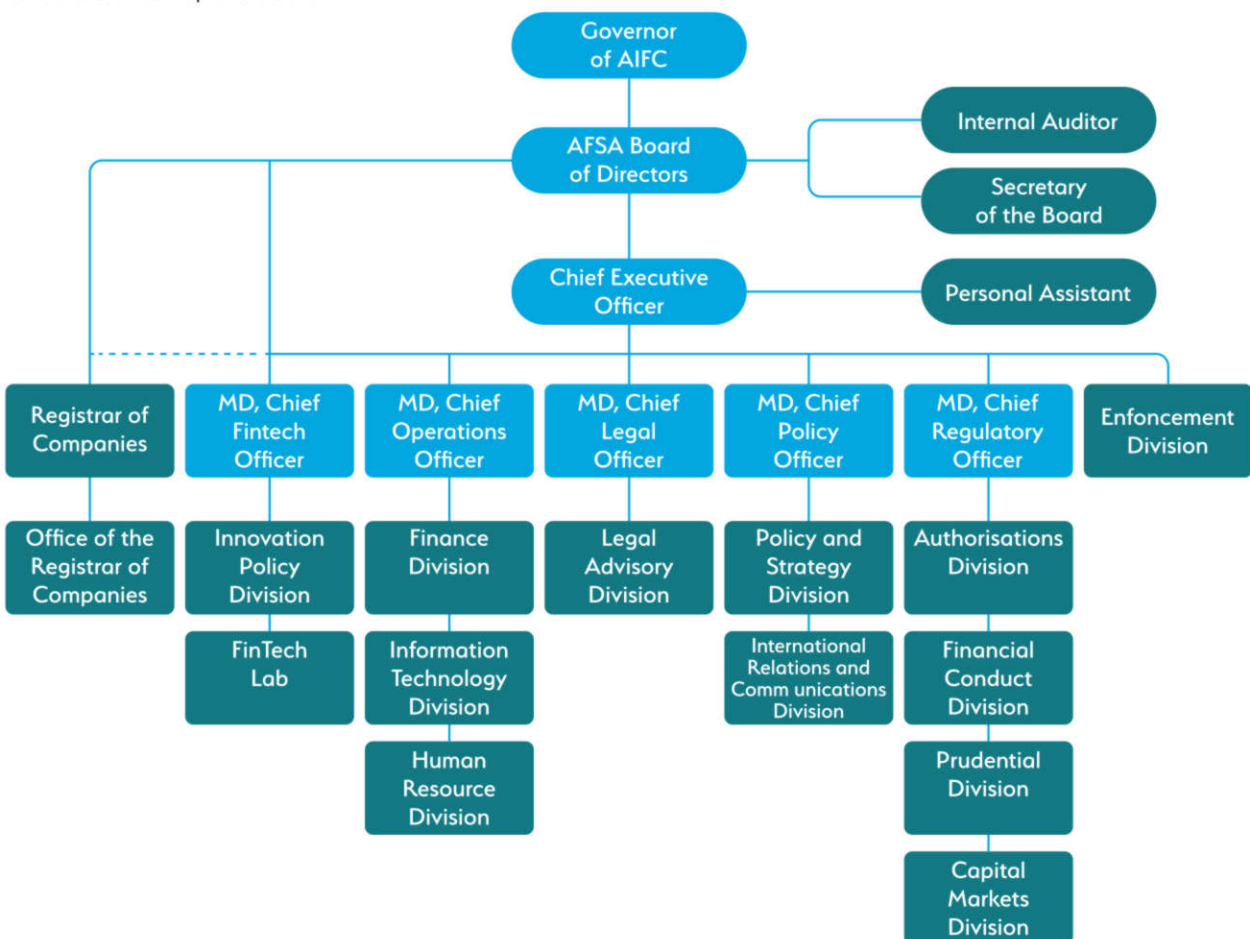
the favourable conditions for the formation of a leading financial centre.

2.2.4 AIFC AUTHORITY

The AIFC Authority was established on 28th December 2015 and is responsible for the development of the overall strategic plan, promotion of the AIFC in the global markets and attraction of the potential participants to the AIFC. The AIFC Islamic Finance and Business Hub is tasked with the objective of ensuring orderly development and growth of Islamic finance and create conditions for an internationally competitive Islamic finance marketplace. To promote the AIFC as the regional hub for Islamic finance, an AIFC Advisory Council on Islamic Finance (“ACIF”) has been established which includes a top-notch and highly reputable international experts with great expertise and vast experience in the field of Islamic finance. The Central Shari’ah Advisory Board (CSAB) of the Astana International Financial Centre (AIFC) is established pursuant to clause 33 of the Joint Action Plan of the Government of the Republic of Kazakhstan and the National Bank of Kazakhstan on establishment and development of the AIFC and for ensuring the formation of the AIFC as a regional hub for Islamic Finance, where Islamic financial products are compliant with Shari’ah law and consistent with the market practices of the global Islamic finance industry in accordance with the Standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

2.2.5 ASTANA FINANCIAL SERVICES AUTHORITY (“AFSA”)

The AFSA was launched on 1st January 2018 as the independent regulator of the AIFC. Its organisational structure is as depicted below:



Its mission is to establish an environment that delivers fair and transparent financial and capital markets, in which individuals and institutions act with integrity.

AFSA’s objectives are the following:

- to regulate, control and supervise financial activities in the AIFC’s participants;
- to ensure the financial markets in the AIFC are fair, efficient, transparent and orderly;
- to create fair, transparent and non-discriminatory conditions for AIFC’s participants ;
- to foster and maintain confidence in the AIFC’s financial system and regulatory regime;
- to foster and maintain the financial stability of the AIFC’s financial services;
- to prevent, detect and restrain actions that may cause damage to the reputation of the AIFC;
- to protect interests of investors and users of financial services;
- to implement in the AIFC a regulatory regime that complies with international standards in the sphere of regulation of financial services; and
- to foster the development of financial technologies in the AIFC.

The AFSA’s scope of regulation covers the following areas:

		<u>Priority Areas</u>
Financial Services	<ul style="list-style-type: none"> ▪ Capital markets ▪ Banking sector ▪ Insurance sector 	<ul style="list-style-type: none"> ▪ Capital markets (AIX) ▪ Asset management ▪ Private banking ▪ Islamic finance ▪ Financial technologies ▪ Green finance
Ancillary Services	<ul style="list-style-type: none"> ▪ Accounting ▪ Audit ▪ Credit rating ▪ Legal services ▪ Consulting services 	
Corporate Regulator	<ul style="list-style-type: none"> ▪ Registrar of companies ▪ Corporate governance 	

Scope of AFSA’s Islamic Finance Regulation

Under the AIFC Islamic finance rules, the relevant entities are allowed to conduct a diverse range of Islamic finance business in a manner that conform with Shari’ah and these include the following:

- Islamic banking;
- Islamic window;
- Islamic financing;
- Islamic insurance and reinsurance (*takaful* and *re-takaful*);
- Islamic fund management; and
- Issuance and offering of Islamic securities including shares and *Sukuk*.

We propose that there be considered for the AIFC a framework for an Islamic investment banking licence business, which will enable an AIFC entity to engage in a wide range of activities including broker-dealership, dealing in investments as principal or agent, advise on investments or credit facilities and arrange for investment deals or credit facilities, which are often the core businesses of investment banks that enable them to earn adviser/arranger fees¹⁸.

¹⁸ An example of an omnibus, common law legislation that contains a framework for Islamic investment banking is the Labuan Islamic Financial Services and Securities Act 2010 which is available here: <https://www.labuanibfc.com/legislation-guidelines/legislation/principal-legislation>

In addition, the relevant entities that undertake and perform the above Islamic financial activities will have to consider the extent to which their business activities are subjected to the relevant prudential requirements arising from the nature of risks or varying nature of risks of their business activities. In this regard, relevant provisions under AFSA's Islamic Banking Business Prudential Rules or any other relevant prudential rules will apply.

Bilateral and Multilateral Linkages

AFSA also establishes multilateral and bilateral international co-operation with other regulatory bodies as follows:

Multilateral (co-operation with global standard setters)

- International Organization of Securities Commissions (IOSCO);
- International Association of Insurance Supervisors (IAIS);
- Basel Committee for Banking Supervision (BCBS);
- Banking Supervisors from Central and Eastern Europe (BSCEE);
- Eurasian group on combating money laundering (EAG/FATF);
- IFSB; and
- AAOIFI.

Bilateral

- Regulatory and supervisory cooperation.

2.2.6 THE AIFC COURT

The AIFC Court provides a common law court system that operates to the highest international standards to resolve civil and commercial disputes in the AIFC. It adjudicates exclusively all claims arising out of the AIFC and its operations and other claims in which all parties to the dispute agree in writing to the jurisdiction of the AIFC Court.

The AIFC Court is separate and independent from the Republic of Kazakhstan judicial system. It has its own court of final appeal, its own procedural rules, a special fast track for small claims and its decisions are supported by a robust enforcement system within the Republic of Kazakhstan.

2.2.7 THE AIFC INTERNATIONAL ARBITRATION CENTRE

The International Arbitration Centre ("IAC") provides an independent, economical and expeditious alternative to court litigation, operating to the highest international standards to resolve civil and commercial disputes in the AIFC.

Parties may agree for the IAC to:

1. Administer their arbitration according to the IAC Arbitration and Mediation Rules. These rules include procedures for expedited arbitrations, the appointment of emergency arbitrators, and resolution of investment treaty disputes.
2. Administer their arbitration according to United Nations Commissions on International Trade Law (UNCITRAL) Arbitration Rules or ad hoc arbitration rules.
3. Administer mediations according to the IAC Arbitration and Mediation Rules or ad hoc mediation rules.
4. Provide other forms of alternative dispute resolution.

2.2.8 AIFC BUREAU FOR CONTINUING PROFESSIONAL DEVELOPMENT LTD. (“BCPD”)

The BCPD is responsible for human capital development and plans to retrain over 2,000+ specialists in the financial industry of Kazakhstan and ultimately, create critical mass of professionals for the AIFC eco-system and beyond. In addition, the BCPD is responsible for investment and financial literacy programs related to the AIFC’s core pillars including Islamic finance, FinTech, capital markets, green finance, as well as asset and wealth management.

2.2.9 ASTANA INTERNATIONAL EXCHANGE (AIX)

As at the end of August 2020, there are 64 listed securities at AIX. Out of these, 47 are debt securities and 5 are equity with 3 being foreign. The first Islamic bonds listed on AIX is Sukuk of Qatar International Islamic Bank (QIIB). Securities denominated in both KZT and foreign currencies including USD, CHF, GBP, CAD, EUR, CNY can be listed on AIX.

2.2.10 AIFC BUSINESS CONNECT

AIFC Business Connect is part of the AIFC Family in the form of a private company focused on driving economic impact into Kazakhstan through AIFC, anticipating international business practices and drivers, and defining suitable projects and structures for potential investment in the Republic of Kazakhstan. AIFC Business Connect conducts market research to implement international best practices, understand needs of customers & develops suitable products. AIFC Business Connect supports finance projects such as Green Finance, Islamic Finance, agriculture, mining real estate and digital.

2.2.11 COMPANY REGISTRATION IN THE AIFC

As at 30th July 2020, there are 515 entities registered with the AIFC based on the AIFC’s Public Register.

The breakdown of entities by types within AIFC mandates are as follows:

	Types	No. of Entities
1.	Authorised Firms	18
2.	Authorised Market Institutions	2
3.	Ancillary Service Providers	106
4.	Recognised Non-AIFC Members	32
5.	Others	357

2.2.12 FINANCIAL INCENTIVES FOR AIFC PARTICIPANTS

The AIFC has established a favourable tax regime in the AIFC territory, providing tax exemptions for the AIFC participants. The AIFC participants are exempted from the following:

1. Corporate income tax (“CIT”) on income received from the provision of the following financial services in the territory of the AIFC:
 - (i) Islamic banking services;
 - (ii) reinsurance and insurance brokerage services;
 - (iii) investment management services for investment funds assets;
 - (iv) brokerage and (or) dealer;
 - (iv) underwriting services; and
 - (v) other financial services stipulated by the AIFC’s Acts¹⁹.

¹⁹ The list of financial services is contained in the following acts of the AIFC: AIFC Financial Services Framework Regulations (Schedule 3: Market Activities) and AIFC General Rules (Schedule 1: Regulated Activities). <https://afsa.aifc.kz/files/legals/325/file/the-list-of-financial-services-provided-by-the-aifc-participants-income-from-which-is-exempt-from-cip-and-vat.pdf>

2. CIT on income received from the provision of ancillary services for example legal, auditing, accounting and consulting services delivered to the AIFC authority, as well as to the AIFC participants providing financial services listed in paragraph i above;
3. A joint order was adopted dated May 26, 2020 No. 126, the Minister of Finance of the Republic of Kazakhstan dated May 29, 2020 No. 547 and the Minister of National Economy of the Republic of Kazakhstan on June 12, 2020 No. 118 "On approval of the List of financial services provided by the participants of the Astana International Financial Center, exempted from the payment of corporate income tax, value added tax", in accordance with which, among other financial institutions, tax incentives are provided for Islamic banking, non-banking, as well as Islamic insurance and reinsurance organizations. Constitutional Statute on AIFC, Article 6, para 8-2: "The services of AIFC Participants mentioned in paragraph 3 of this article are exempt from value added tax".
4. Property and land taxes on facilities located in the AIFC territory, in case they provide financial (i) or ancillary (ii) services above.

In addition, foreign citizens employed by the AIFC participants are exempt from individual income tax on income from activity in AIFC generated under an employment contract with an AIFC participant involved in the provision of financial (i) or ancillary (ii) services.

In all other cases, taxation is carried out in accordance with the established procedure, including the norms of the conventions on the avoidance of double taxation (if applicable). To date, there are 53 conventions for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains concluded by the government of Kazakhstan with foreign countries.

In conclusion, the AIFC has set in place the infrastructure and framework upon which to build an international financial centre that will be able to serve the region and beyond. As of the date of this Master Plan, it is continuing to strengthen and augment the existing infrastructure and framework.

CHAPTER 3: VISION AND ASPIRATIONS

3.1 KAZAKHSTAN NATIONAL VISION

The Kazakhstan government has set its sight to be amongst the Top 30 advanced global economies by 2050. To realize this vision, the government aim to reduce the state's financial footprint and foster economic diversification by improving the business environment, making public administration more service-oriented and efficient, investing in enabling infrastructure including transportation and information (IT), and undertaking public-private-partnerships (PPPs). These efforts represent a transition from substantial state support in recent years with hopes of attracting more foreign investments into the non-oil sectors of the economy. To help lessen the dependency on commodity exports, it is vital to support economic diversification by promoting and intensifying private sector development and improving access to finance. Strengthening the financial system and its architecture is a vital infrastructure component to support this agenda.

According to Asian Development Bank's Country Partnership Strategy 2017-2021 Report, Kazakhstan's present state of the financial services industry remain plagued with structural weaknesses. The poor performance and governance of Kazakhstan's financial sector has impeded private sector development in non-resource based tradable goods and services. The private sector faces high costs and limited financing options, especially for long-term projects as:

- legacy and hidden nonperforming loans threaten banks' capital adequacy, and nonperforming loans have not been addressed comprehensively and transparently;
- sizeable foreign currency liabilities of the banking sector increases solvency risks if exchange rate volatility returns;
- subsidized government lending through commercial banks is undermining the new interest rate targeting monetary policy and creating distortions in money markets, while holding back capital and debt market development;
- high interest rate margins persist because of weak appraisal and risk management capabilities for credit, liquidity, and interest rate risk; and
- underdeveloped capital and debt markets constrain the maturity transformation role of the financial sector, which makes the provision of long-term financing options disproportionately costly.

This limits the ability to adopt viable PPPs and other financing mechanisms for infrastructure projects. In this regard, Islamic finance is seen as one key avenue to further broaden, diversify and deepen the financial sector, help stimulate capital formation, spur economic growth to be driven primarily by the private sector as well as strengthen public and market institutions. Kazakhstan also considers the development of Islamic finance as a way of diversifying financial services in the country and as a condition for attracting investors from the Middle East and Southeast Asia. The NBK has taken steps to establish a level playing field for IFIs. Special legal provisions were introduced in the Tax Code to ensure the equal treatment for both Islamic and conventional financial products.

3.2 ISLAMIC FINANCE VISION

The vision for Islamic finance in Kazakhstan is in general to increase the level of Islamic assets to reach at least 3% of total financial assets by 2025. Currently, according to the data as provided by the ARDFM, the level of Islamic banking assets in comparison to the total banking assets within Kazakhstan is less than 1%. This low figure is mainly due to a lack of the necessary infrastructure and the apparent operational gaps which make potential stakeholders hesitate or simply unable to participate in Islamic finance, caused partially by the piecemeal basis through which Islamic finance is introduced within Kazakhstan. It is this Master Plan's goal to introduce a holistic and broad spectrum of strategies which will set up the necessary infrastructure for the development and sustainability of Islamic finance in Kazakhstan and the AIFC.

London and Hong Kong can be exemplary to Kazakhstan in terms of realizing its Islamic finance vision. London has claimed itself to be the leading Islamic financial centre for a non-majority Muslim country. With over 20

banks offering Islamic financial services, London has reinforced itself as a western Islamic finance hub. Hong Kong have made efforts to establish outbound Islamic financing frameworks and encouraged relevant entities to provide Islamic financing products. Interestingly, both countries have set in place relevant frameworks to support Islamic finance.

3.3 TARGET ACHIEVEMENTS

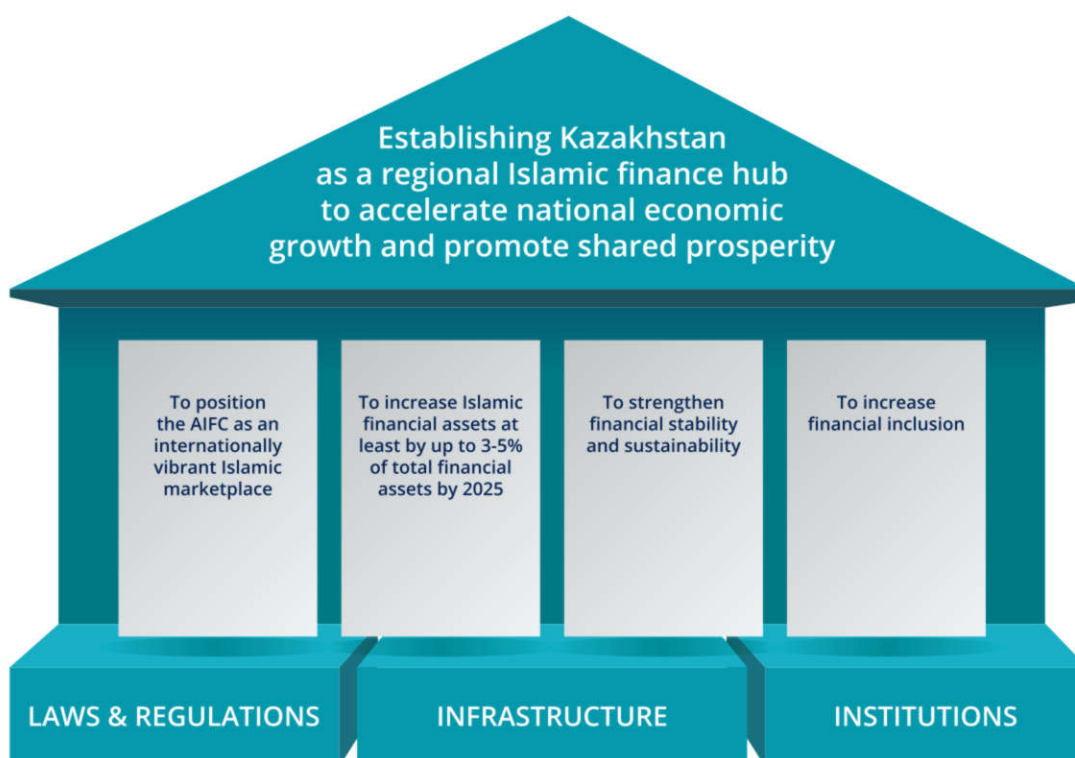
- Develop an Islamic Finance Department in the Agency for Regulation and Development of Financial Markets (“ARDFM”) and Astana Financial Services Authority;
- Establish a high-level committee for the Islamic financial sector involving key regulatory authorities who will coordinate and collaborate together to drive the implementation of this Master Plan;
- Promote Shari’ah compliant capital formation and mobilisation;
- Increase use of digital technology to achieve financial inclusion;
- Enable Islamic banking, *takaful* and microfinance windows;
- Position the AIFC as the sole regional platform offering holistic solutions for Islamic financial business and transactions;
- Establish a regional research and training centre; and

3.4 STRATEGIC OBJECTIVES AND PILLARS

This Master Plan has been framed around the vision of “Establishing Kazakhstan as a regional Islamic finance hub to accelerate national economic growth and promote shared prosperity”. With this in mind, the main strategic objectives of this Master Plan are:

- i) To position the AIFC as an internationally vibrant Islamic marketplace;
- ii) To increase Islamic financial assets at least by up to 3-5% of total financial assets by 2025;
- iii) To strengthen financial stability and sustainability; and
- iv) To increase financial inclusion.

This Master Plan’s foundational pillars and core drivers to achieve these strategic objectives are: (i) Laws and regulations, (ii) Infrastructure, and (iii) Institutions.



CHAPTER 4: THE INTERNATIONALISATION OF AIFC

4.1 INTRODUCTION

Any internationalisation effort and initiatives of the AIFC in the area of Islamic finance will need to be holistically considered from the perspective of a SWOT analysis (strengths, weaknesses, opportunities and threats) on the AIFC itself, which can be broken down as follows:

4.1.1 STRENGTHS

- (i) The AIFC has set in place the requisite soft and hard infrastructure as well as a competitive environment to function and operate as a financial centre. The existence of a sound ecosystem builds a strong value proposition for the AIFC to internationalise its core pillars including promoting Islamic finance and leverage on this capability to build a link that will bring fundamental economic benefits to Kazakhstan consistent with its national objectives and agenda.
- (ii) The AIFC's current Islamic finance framework allows for relevant entities to conduct a diverse range of Islamic finance business such as Islamic banking, Islamic window, Islamic financing, Islamic fund management, issuance and offer of securities including shares and *Sukuk* and facilitated by national taxation regime to support Islamic finance business and transactions.
- (iii) AIFC Business Connect was created to engage best International practice and experience and world-wide market knowledge with the goal of attracting new AIFC participants and supporting existing ones. Throughout its work, AIFC Business Connect was able to support the registration at AIFC of companies from 42 different countries.

4.1.2 WEAKNESSES

- (i) While the AIFC has in place a comprehensive ecosystem supporting the financial market including Islamic finance, it has yet to establish and build the required capability needed to drive its regional aspirations notably in terms of the presence of international players and talents offering a suite of services and solutions to regional players for fund-raising, investments, wealth and asset management. As at the end of August there are 64 securities listed on AIX of which 47 are debt and 5 are equities of which 3 are off-shore. There is one Islamic instrument cross-listed on AIX so far²⁰.
- (ii) The AIFC as a marketplace currently lacks a vibrant environment both in terms of core market participants, business and financial transactions as well as the presence of external liquidity. The large number of ancillary service providers in the AIFC currently have yet to deliver substantive tangible results either in terms of domestic or international deals and transactions. The absence of a framework for Islamic investment banking business would also have a direct impact on the origination and market-making capabilities within the AIFC.
- (iii) One of the game-changing factors i.e. government-controlled institutions such as Sovereign Wealth Funds ("SWFs"), State Owned-Enterprises ("SOEs"), pension institution(s) and other key agencies who are in a position at this early stage to shape, influence and drive market development efforts, have not responded in a way that could energise and be the catalysts to attract international players, business and financial deals and liquidity into the AIFC.

²⁰ AIX's official list taken from <https://www.aix.kz/listings/listed-companies/> as at 10 April 2020.

4.1.3 OPPORTUNITIES

- (i) The competitive nature of the AIFC's financial and non-financial ecosystem currently is capable of supporting the internationalization of Islamic finance.
- (ii) Government-initiated privatisation of state assets through SOEs could spur further expansion and potentially attract new source of external liquidity including Islamic finance.
- (iii) With the government's policies of privatising state assets, there is room for the Micro, Small and Medium Enterprises ("MSMEs") sector to grow within the supply and value chain of the privatised entity. Together with other potential growth sectors such as agro-business, mining and construction, the opportunity to attract international PE players (including for such players to establish Islamic windows) to set-up operations in the AIFC is bright.
- (iv) The AIFC could leverage on its Islamic financial business frameworks, for example Islamic wealth, asset and fund management, Islamic PE and VC and Islamic banking and Islamic windows, to attract international players to base their regional operations in the AIFC.
- (v) Kazakhstan's participation in China's Belt and Road initiative could influence and induce the use of Islamic finance to fund related infrastructure projects.
- (vi) AFSA's regulatory sandbox and the AIFC's FinTech hub infrastructure present opportunities for domestic participants to development and grow the e-commerce industry and electronic payments beyond the traditional intermediated model.
- (vii) Geopolitical and regional developments, for example USA and European Union sanctions on Russia, and present a window of opportunities for Kazakhstan's AIFC to act as the region's financial hub as well as an economic and business gateway to the CIS region.
- (viii) The AIFC could take advantage of its first mover advantage and the increasing interest shown in Islamic finance by regulatory authorities and other industry players in surrounding countries such as Uzbekistan, Tajikistan, Azerbaijan, Kyrgyzstan and Tatarstan, to attract significant Islamic business to its platform.

4.1.4 THREATS

- (i) AIX is a relatively new exchange which employs the expertise and solutions provided by NASDAQ. KaSE in turn is striving to strengthen its position entering into cooperation with other regional exchanges, for example the Moscow Exchange to have a mutual access into their respective trading platforms. The competition between two exchanges may have implications on further development of the capital market.
- (ii) Neighbouring countries such as Uzbekistan through its economic reform programmes could potentially play catch-up and pose as a serious competition to the AIFC and the AIX in the future if the AIFC fails to prove itself as a well-developed financial centre.

4.2 ISSUES AND CHALLENGES

The AIFC has been able to establish a trusted platform to promote domestic and regional fund-raising, financing and investments backed by sound legal system and regulatory frameworks benchmarked against international standards. The financial centre is further reinforced by an attractive incentive-system i.e. income tax exemptions and strong supervisory architecture to encourage the participation of financial intermediaries in core sectors and ancillary service providers to set-up their base and operations within an exclusive zone. These factors give the AIFC at a certain advantage against any other domestic and regional peers in terms of competitiveness and readiness to tap into any given opportunities.

The future of the AIFC, however, is not free of challenges. One obvious issue is that the Kazakhstan market and capital market alone are not big enough to remain constantly active, and attractive. It is therefore imperative that the AIFC presents itself as the natural conduit through which investors can do business with other Central Asian countries beyond Kazakhstan, and highlight AIFC's regional positioning. Further, state assets, for example government-controlled institutions such as SWFs, SOEs, pension institutions and other key agencies who are in a position at this early stage to shape, influence and drive market development efforts, need to respond in a way that could energise and attract international players, business and financial deals and liquidity into the AIFC. Likewise, ambiguity and inadequacy in the operation of taxation treatment for Islamic finance transactions remain an issue that require a comprehensive and holistic review and solution despite it being stated that changes were already made to Kazakhstan's national tax code.

The AIFC's immediate task is therefore to establish a vibrant marketplace with the presence of world-class intermediary institutions undertaking the AIFC's core regulated activities offering both Islamic products and services capable of servicing the needs of the domestic market as well as the region and generating activities in Islamic business and transactions.

While the number of the AIFC's participants is growing, the lack of core participants remains a concern. To date, there are only 18 authorised firms carrying out the AIFC's regulated activities, 2 authorised market institutions, 95 ancillary service providers and 32 recognised non-AIFC members while the total number of entities registered is 515 as at 30th July 2020²¹. The low number of core participants is reflected in the small number of financial market transactions and lack of secondary market liquidity. The more immediate challenges facing the AIFC since its launch in 2018 include the following:

4.2.1 NEED TO DEVELOP THE AIFC'S GLOBAL CAPABILITY IN THE ORIGINATION OF ISLAMIC FINANCIAL TRANSACTIONS AND ITS DISTRIBUTION WITH ACCESS AND AS GATEWAY TO THE REGION'S MARKETS

While it is currently armed with a sound financial services ecosystem, the AIFC's immediate priority should be to develop the type of capabilities which could harness and tap domestic and regional opportunities. Failing to position the AIFC as a credible regional Islamic marketplace for the origination of international financial deals serving the region's mainly Muslim countries would deny the AIFC a strong value proposition in its efforts to attract the presence of global and international players. The presence of these international Islamic intermediary institutions will have the capability to offer competitive Islamic products and services for the region and provide the opportunity to build scale. However, as previously highlighted, their presence has so far been absent and this in turn affect the AIFC's presence as an Islamic finance hub for the region. Islamic finance's value-based system anchored on social justice, fairness and sustainability ought to be highlighted to add to the attractiveness for businesses and investors alike.

In facilitating and accommodating international banks into the AIFC, it must be noted that banks either expand by themselves or alongside strategic partners, through an equity or non-equity deal. Many banks internationalise to follow domestic clients operating in foreign markets while others do so to expand markets, to increase profit or to take advantage of different regulatory systems. Strategies selected for entering the market or consolidating market positions will depend on the degree of ownership, resources and risks involved. In this respect, the AIFC should ensure that its framework is fully capable of accommodating any bank (whether traditional bank or investment bank) regardless of the type of bank and the strategies that they opt for, in establishing presence in the AIFC. One type of regulatory approach will not be able to fit all types of internationalisation exercises; hence, a principle-based and progressive framework should be considered.

²¹ AFSA Public Register, retrieved from <http://ofsa.kz/public-register> as at July 2020.

4.2.2 BROADENING THE AIFC'S INVESTOR AND LIQUIDITY BASE WITH EXPOSURE TO THE REGION'S GROWING OPPORTUNITIES

Through Islamic financial transactions within the AIFC, international investors will have the opportunity to obtain exposure to the region's growth potential notably in certain segments of the region's economy where the predominantly resource-based industry is naturally compliant with Shari'ah principles. Allowing dealings in foreign-denominated currency should further boost the AIFC's prospects as the centre for origination and distribution and attracts the much-needed liquidity into Kazakhstan. However, this potential is not facilitated by involvement of the SOEs, which remain dominant within Kazakhstan's economy especially in the commodity sector.

As countries in the region undertakes reform and diversify its economy, the AIFC should not delay in highlighting to the SOEs the opportunities to use Islamic finance as the platform for fund-raising, listing and investments and attracting international liquidity. Similarly, China's growing infrastructure investments through its China's Belt and Road initiatives in the region presents a substantial opportunity for the AIFC to be the regional platform for Islamic fund-raising and investments with participation from Chinese institutional investors.

4.2.3 EXPANDING CONNECTIVITY AND LINKAGES FOR MARKET ACCESS AND BUILDING SCALE

Leveraging on a credible platform that meets international standards, the AIFC's market participants stand to reap the benefits of scaling-up their businesses and operations by establishing greater linkages with other established markets. The challenge for the AIFC via AFSA in this regard will be to constantly identify bilateral and multilateral arrangements that can provide the platform for the AIFC participants to sell and distribute their products in new markets seamlessly. Establishing such linkages are important as it will pave the way for a smoother process of distribution of financial products without being unduly hampered by cumbersome regulatory processes by the host jurisdiction. For example, a failure to create robust and diverse double taxation agreements between mainland Kazakhstan and other jurisdictions with extension to the AIFC will hamper efforts to make it more attractive to investors in regard to repatriation of profits from investments without the cumbersome hurdles of withholding taxes. The AIFC, while already having an impressive array of soft infrastructure, need to consider how it should act as a link between mainland Kazakhstan-AIFC-the region.

4.2.4 ALIGNING ISLAMIC FINANCE VALUE-BASED SYSTEM WITH CURRENT GLOBAL MOVEMENT ON SUSTAINABLE AND RESPONSIBLE FINANCE

Islamic finance principles which are closely associated with risk sharing and the real economy as well as its due emphasis on social justice and fairness have been duly recognised internationally as part of the global sustainable and responsible finance and investment practices supporting the achievement of the sustainable development goals ("SDGs"). As such, positioning the AIFC's Islamic finance value proposition in association with SRI in its broad range of products and services offerings should draw wider participation from a diverse range of stakeholders. Should the AIFC succeed, this will attract conventional SRI investors, in addition to the traditional investors and brand the Islamic finance industry (especially in the AIFC) as more socially responsible, competitive and attractive. This aspect of Islamic finance is a key potential growth area that also aligns with the AIFC's core principles.

4.2.5 ESTABLISHING A REGIONAL CENTRE OF EXCELLENCE FOR ISLAMIC FINANCE

The BCPD has the potential to build capacity beyond the traditional re-skilling and up-skilling of domestic talent to meet the industry's operational needs and position itself as a centre of excellence for the region. Leveraging on its first mover advantage in Islamic finance, the AIFC should set its sight on becoming the reference point for stakeholders and talents across the Central Asia region for thought leadership, research

and industry best practices on Islamic finance. It should cater not only to domestic market participants, regulators and the academic community, but also to regional players with a view to promote industry development, thought leadership, innovation and growth.

4.3 RECOMMENDATIONS

The AIFC has set its ambition on becoming a regional financial centre and aims to be the Top 20 leading Asian financial centres within 10 years from its launch. Designed to be a trusted platform, the AIFC is intended to enable Kazakhstan to achieve the goal of joining the Top 30 developed economies by 2050.

Islamic finance as one of the 5 core pillars of the AIFC may further deepen Kazakhstan’s financial market and help broaden the avenue for financing the country’s real economy and spur private sector investments in line with the government’s agenda to modernise and diversify its economy, anchored on the private sector as an engine of growth and service delivery.

Further, Islamic finance’s unique value-based propositions brings it closer to the principles of ethical and sustainable finance. Associating the element of internationalisation with Islamic finance makes the proposition for an Islamic financial centre more compelling; even more so when it is intended to serve and reinforce the commercial and ethical needs of the domestic market as well as that of the region.

The internationalisation proposition is further strengthened by the fact that it is reinforced by sound and internationally benchmarked financial ecosystem including a competitive legal, regulatory and financial architecture together with the deployment of cutting-edge infrastructure and technology.

The AIFC’s internationalisation of Islamic finance therefore requires designing a competitive and fit-for-purpose strategy with clear outcomes. We recommend 5 strategic pillars that centres around; building the right capability to deliver global Islamic solutions, boosting external liquidity into the Islamic financial system, strengthening connectivity and building linkages, aligning Islamic finance with global sustainability practices and promoting the AIFC as the centre of excellence for Islamic finance. This strategy is intended to deliver greater scale, enhance efficiency and boost the international competitiveness of the AIFC as regional financial centre.

Premised on these 5 strategic pillars and leveraging on its current strength and identified growth opportunities, the following initiatives and recommendations will seek to drive the AIFC as a vibrant and competitive marketplace for Islamic finance. The strategic initiatives and recommendations are as follows:

Strategic Initiatives	Recommendations
1. Build international Islamic intermediation capabilities.	<ul style="list-style-type: none"> i. Develop Islamic seeding strategy to attract presence of global banks, asset and wealth managers and offer innovative and diverse banking facilities and fund structures; ii. Expand scale through regional access in the origination and distribution segments of Islamic business and transactions; iii. Strengthen Islamic service and operational infrastructure to expand international reach; iv. Promote development of disruptive Islamic financial and digital technology; and v. Promote development of innovative <i>takaful</i> and <i>re-takaful</i> activities.
2. Widen global and regional investor and liquidity base.	<ul style="list-style-type: none"> i. Accelerate privatisation of SOEs, integrate Islamic financing and listing as Islamic IPO;

	<ul style="list-style-type: none"> ii. Develop legal infrastructure for Islamic trusts, foundation and philanthropy; iii. Build attractive wealth management ecosystem to bolster presence of family offices and foundations; iv. Build scale in the Shari'ah compliant equity, <i>Sukuk</i> and Islamic investment management segments; v. Establish the AIFC as the main financing and investment platform for the Belt and Road initiatives in Central Asia; and vi. Clarity in the legal framework as to the ability of players to market their products and services beyond the AIFC to the rest of the Central Asia and CIS regions.
3. Expand international connectivity and regulatory linkages.	<ul style="list-style-type: none"> i. Pursue cross-border regulatory arrangements to facilitate market access and expansion of domestic intermediaries; ii. Develop and participate in regional passporting regime on banking activities and investment funds including Islamic banking and investment products²²; and iii. Expand Double-Taxation Agreements inclusive of the AIFC for competitive withholding tax rates.
4. Promote Islamic finance as value-based finance and investments.	<ul style="list-style-type: none"> i. Establish SRI/green bond and <i>Sukuk</i> incentive scheme to attract domestic and regional issuers of SRI/green <i>Sukuk</i>; ii. Procure collaboration with and technical assistance from multilateral institutions and institutional bodies promoting sustainable finance; iii. Benchmark domestic frameworks on sustainable finance and investments with international principles, standards and best practices; and iv. Promote and position Islamic social finance to strengthen financial inclusion.
5. The AIFC as a reference point for Islamic finance development, standards and innovation.	<ul style="list-style-type: none"> i. Establish the AIFC as a regional, go-to place and centre of excellence for Islamic finance.

The detailed recommendations arising from these 5 strategic initiatives are as follows:

²² Under the relevant European Union (EU) directives, one avenue for financial institutions in the United Kingdom (UK), including Islamic ones, to expand is to 'passport' their business activities into any one of the EU member states (and vice versa). Concerted efforts have been made within the EU to form a single market for financial services; and UK-authorized institutions may offer products throughout the EU without the need to have separate authorisation in each member country. This means that Islamic institutions that 'passport' would have access to an estimated 15 million potential customers. The Bank of London and the Middle East is the first Islamic bank to have taken advantage of a cross-border services passport, which enables it to offer its products and services across all EU member states, without a physical presence in the host country. Such passporting regime is intended to promote greater scale. "Islamic Finance in the UK: Regulations and Challenges", *Financial Service Authority*, November, 2007. Retrieved from https://www.isfin.net/sites/isfin.com/files/islamic_finance_in_the_uk.pdf

4.3.1 STRATEGIC INITIATIVE 1

BUILDING INTERNATIONAL ISLAMIC INTERMEDIATION CAPABILITIES

- (i) **Develop an Islamic seeding strategy to attract presence of global banks, asset and wealth managers and offer innovative and diverse banking facilities and fund structures**

While the AIFC has established itself as a trusted platform backed by a robust and competitive infrastructure, its immediate challenge is to create a vibrant marketplace characterised by the presence of diverse market participants conducting or involved in regulated activities. At this nascent stage, the role of the government and its agencies as early participants who lead by example and become the first to show confidence in the AIFC, is critical. Leveraging on its national assets as catalysts for development and growth of the AIFC as an Islamic financial hub is essential to foster the presence of international intermediary institutions and attract external foreign liquidity into the AIFC. A seeding mechanism and the leveraging of these national assets including the SWFs, SOEs, pension and national funds, the NBK's treasury operations to create international deals will harness global capability within the AIFC and strengthen its offering of financial and business solutions to markets within the region. Perhaps this seeding strategy can be formulated at a small scale with participations from national companies such as the DBK or DAMU. We have prepared a hypothetical simulation on the possible scenario of such participation as part of our Appendix 1.

- (ii) **Expand scale through regional access in the origination and distribution segments of Islamic business and transactions**

By establishing international connectivity and linkages, the AIFC can act as the pathway for the origination of international business and financial transactions out of the AIFC. Bilateral or multilateral arrangements between the AIFC and external (especially regional) jurisdictions will reinforce access into new or neighbouring markets with minimal disruptions to financial transactions, paving the way for business to scale-up their operations and enhance business competitiveness at optimum cost and with timeliness.

- (iii) **Strengthen Islamic services and operational infrastructure to expand international reach**

The AIFC as a trusted platform requires operational infrastructure to support the needs of intermediaries and markets. For the Islamic markets, operational tools such as a Commodity *Murabahah* platform that provides services for the structuring of financial products and liquidity management for issuers of securities and Islamic intermediaries will help make the AIFC the hub for origination of Islamic financial transactions and make Islamic banks (including Islamic investment banks) and other financial institutions within it more competitive.

Considering Kazakhstan's wealth of natural resources and commodities, the AIFC ought to consider establishing its own Commodity *Murabahah* platform, which could serve the AIFC's participants, mainland Islamic operations and the region as a whole.

- (iv) **Promote development of new Islamic financial and digital technology**

The application of digital technology in markets and regulatory operations are now mainstream. The role of technology will become even more significant as time progresses. The consequence of such technological disruption will have profound and diverse impacts in many aspects notably in building efficiency and scale but also promote an inclusive financial system. This ranges from greater access to financial services to tapping new opportunities, alleviation of hardships and poverty, to the more sophisticated segment of the market such as digital assets and exchanges and virtual banking, etc. Challenges on matters of cybersecurity, digital fraud and digital literacy will need to be dealt with to ensure orderly growth of the marketplace.

(v) Promote development of innovative *takaful* and re-*takaful* activities

Taking into consideration, among others, that in Kazakhstan and Central Asia the general insurance segment dominates the insurance sector, the AIFC should consider developing and positioning itself to develop and strengthen innovative *takaful* and re-*takaful* activities especially those such as captive *takaful*. In captive *takaful* (similar to the conventional captive structure), a captive company is used as a strategy by a risk owner as contemporary risk management tool to manage risk and curb loss in a Shari'ah compliant manner.

4.3.2 STRATEGIC INITIATIVE 2 WIDEN GLOBAL AND REGIONAL INVESTOR AND LIQUIDITY BASE

(i) Accelerate privatisation of SOEs, integrate Islamic financing and listing as Islamic IPOs

As stated in the National Plan, the push for diversification of the economy will see the private sector as the main anchor for economic growth. The acceleration of SOEs privatisation and their eventual listing in the AIFC will be able to help drive development of Islamic finance including the capital market and become the catalysts for internationalisation through foreign participations in such deals. Likewise, the privatisation process can integrate and drive a multitude of Islamic financial activities including financing, investment, wealth and asset management within the AIFC with international participation throughout the value chain.

(ii) Develop legal infrastructure for Islamic trusts, foundation and philanthropy

The AIFC can tap regional opportunities arising from geopolitical developments in neighbouring countries and together with its strategic positioning within the Central Asia region, Kazakhstan is well positioned to potentially attract captive wealth and liquidity. The existence of relevant legal Islamic structures and vehicles will facilitate the housing of these captive assets and help attract international intermediary institutions in the AIFC to offer diverse capabilities with competitive business and financial solutions²⁵.

(iii) Build attractive wealth management ecosystem to bolster presence of family offices and foundations

The establishment and presence of the AIFC's attractive legal infrastructure notably broad double taxation arrangements, legal structures together with private banking and wealth management services will help bolster the presence of regional family offices and foundations into the AIFC. Bringing with them regional wealth and liquidity, the AIFC will provide the platform and act as the gateway for international investments by offering safe and secure business propositions.

(iv) Build scale in the Shari'ah compliant equity, *Sukuk* and Islamic investment management segments

The organic growth of the AIFC will require time. To accelerate growth, the AIFC will require the presence of abundance of products and services including Shari'ah compliant products within the AIFC. This will require establishing strategic alliances, international linkages and connectivity. Likewise, the AIFC will have to embrace the principle of proportionality in both regulation and oversight that will ensure the continuous supply of diverse and innovative financial products from within and outside the AIFC to meet the varying needs and risk appetite of investors.

²⁵ We note that the AIFC has adopted Trust Regulations in August 2019, and Foundation Regulations prior to that. Moving forward, we recommend that there is a concise guidance on Shari'ah governance for parties interested in establishing a Shari'ah compliant foundation or trust.

(v) Establish the AIFC as the main financing and investment platform for the Belt and Road initiatives in Central Asia

The Shanghai Stock Exchange is a Chinese shareholder of the AIFC's only stock exchange, AIX. China-based financial institutions also have presence in the AIFC, with China's Belt and Road initiatives being aggressively undertaken within the region. The presence of these financial intermediaries can and will help bolster and attract Chinese investors and liquidity into the AIFC for deployment as financing and investments into the Belt and Road regional projects.

(vi) Clarity in the legal framework as to the ability of players to market their products and services beyond the AIFC

Additional clarity in operationalising the various AIFC frameworks will help remove current ambiguities and uncertainties especially in aspects where overlapping authorisation, supervisor and enforcements functions could potentially exist. Joint publication by the relevant agencies of practice notes and guidance will help provide greater clarity to the AIFC participants who wish to offer their services not just within the AIFC but beyond, including into mainland Kazakhstan. Enhancing transparency into such operational oversight matters will facilitate the planning and execution of the respective business strategies of the AIFC Participants. The AIFC and the proposed joint committee of regulatory authorities ought to manage obstacles and ambiguities resulting from bureaucratic delays and inconsistencies, which could send negative signals to potential players.

4.3.3 STRATEGIC INITIATIVE 3 EXPAND INTERNATIONAL CONNECTIVITY AND REGULATORY LINKAGES

(i) Pursue cross-border regulatory arrangements to facilitate market access and expansion of domestic intermediaries

Establishing connectivity and linkages between the AIFC and their external counterparts are vital to pave the way for the AIFC's participants to sell and distribute their Islamic financial products and services into new markets and help build scale and enhance business competitiveness. Such arrangements will alleviate existing barriers and improve logistical efficiency. This will require the AIFC to benchmark its current legal, regulatory and operating frameworks against international best practices and standards and periodically review such benchmarks to ensure they remain up-to-date, robust and dynamic. The AIFC would also need to proactively reach out to regulatory authorities, industry players and associations within the entire region.

(ii) Develop and participate in regional passporting regimes on banking activities and investment funds including Islamic banking and investment products

There are existing regional passporting regimes as well as developing ones involving various regions globally. For the AIFC to be a successful financial centre, being part of such platforms is vital to support its internationalisation aspirations. Financial products will be able to flow more freely between member jurisdictions at a more cost-efficient pace. Such platforms will enable the AIFC to grow exponentially in terms of making available diverse investment products to its stakeholders and participants, which are especially critical to support the presence and deployment of external liquidity within AIFC in search of yield.

(iii) Expand Double-Taxation Agreements (DTAs) inclusive of AIFC for competitive withholding tax rates

Withholding tax has been one of the more lingering concerns of international investors as they seek to invest internationally. Certainty over withholding tax treatment, for example exemption or reduction withholding taxes, in repatriating profits back to their home jurisdictions via any offshore/onshore centres

will provide a tax efficient structure and attract presence of the preferred legal structures and liquidity within the AIFC. Expanding the list of countries with DTAs will broaden the investment horizon and make the AIFC as attractive destinations for global investments.

4.3.4 STRATEGIC INITIATIVE 4 PROMOTE ISLAMIC FINANCE AS VALUE-BASED FINANCE AND INVESTMENTS

(i) Establish SRI/green bond and Sukuk incentive scheme to attract domestic and regional issuers of SRI/green Sukuk

The sustainable finance and investment market is relatively nascent and its mechanism require adherence to additional criteria leading to additional costs to meet the expectations of global SRI/green investors in line with international best practices. As such, establishing parity and a level playing field with conventional bond and *Sukuk* structures and issuance is imperative. A financial scheme that would incentivize issuers of SRI/green *Sukuk* and any other SRI/green financial products will make this segment competitive and facilitate market growth.

(ii) Procure collaboration with and technical assistance from multilateral institutions and international bodies promoting sustainable finance

As multilateral institutions such as the World Bank Group and its network of other international institutions play a pivotal role to achieve the global agenda on sustainable development, they have embarked on programmes to promote sustainable finance and investments while they themselves have acquired the capability to raise SDG-related funding and finance SDG-related projects. The transfer of these capabilities in the form of regulatory infrastructure, systems and processes and market-driven strategies to domestic competent authorities will help drive, develop and grow the sustainability market domestically and regionally.

(iii) Benchmark domestic frameworks on sustainable finance and investments with international principles, standards and best practices

In jurisdictions and markets where savings mobilisation has not reached a mature stage to support mass capital formation, attracting external SRI liquidity to support domestic growth in the SRI market may prove vital. Formulating domestic frameworks that integrates international principles, standards and best practices will help enhance SRI investors' trust and confidence in the internal domestic systems and processes as issuers deploy market-based solutions to finance their SRI projects and financing activities.

(iv) Promote and position Islamic social finance to strengthen financial inclusion

One unique Islamic finance value proposition is its strong emphasis on social justice and fairness. Its redistributive mechanism through the likes of almsgiving (*zakat*), *sadaqah*, *waqf* are credited with modern social finance to address imbalances in terms of wealth and living standards. The resurgence of *waqf* as a tool to harness existing and new assets to its full potential are being actively explored. One of the mechanics is integrating *waqf* with markets and there have been proven and successful models where Islamic capital market instruments were used to monetise and securitise *waqf* assets with social impact.

4.3.5 STRATEGIC INITIATIVE 5

AIFC AS A REFERENCE POINT FOR ISLAMIC FINANCE DEVELOPMENT, STANDARDS AND INNOVATION

(i) Establish AIFC as a regional, go-to place and centre of excellence for Islamic finance

The growing interest in Islamic finance within the Central Asia region both from its governments and populations have given rise to the need to build greater capacity. The AIFC and Kazakhstan have what it takes to offer leadership, knowledge and skills on Islamic finance to the region. It has ready institutions and the platform to offer thought leadership on key and strategic aspects of Islamic finance.

4.4 ACTION PLAN

4.4.1 STRATEGIC INITIATIVE 1

BUILDING INTERNATIONAL ISLAMIC INTERMEDIATION CAPABILITIES

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to increase Islamic investment outsourcing by the pension institution, national funds and treasury of the NBK.						AIFC Authority, NBK
2.	Suggest to attract presence of international financial institutions (whether traditional banks or investment banks) through government-led initiative for the origination and distribution of Islamic products and activities in the region.						AIFC Authority, ABC
3.	Suggest to attract internationally recognised trading platform operator to support Islamic liquidity management of IFIs, issuance of <i>Sukuk</i> and other Islamic products and services/ Establish a Commodity <i>Murabahah</i> platform in the AIFC serving the region.						AIFC Authority
4.	Suggest to develop <i>Sukuk</i> Guidelines.						AIFC Authority AFSA,
5.	Suggest to consider enhancement of Islamic Asset and Fund Management framework for example by introducing guidelines for Islamic Unit Trusts Fund, Islamic Mutual Fund and Islamic Fund Management.						AIFC Authority
6.	Suggest to promote and facilitate the cross and dual listings of Islamic listed funds – Islamic Real Estate Investment Trusts (REITs)						AIFC Authority, AIX

	and Islamic Exchange Traded Funds (ETFs) on AIX.						
7.	Suggest to attract global private equity players offering Islamic investments through Islamic windows.						AIFC Authority, ABC
8.	Suggest to formulate tax incentives for issuers and investors of <i>Sukuk</i> for example tax deductions on expenditure incurred for <i>Sukuk</i> issuances.						AIFC Authority, Ministry of Finance, Ministry of National Economy

4.4.2 STRATEGIC INITIATIVE 2 WIDEN GLOBAL AND REGIONAL INVESTOR AND LIQUIDITY BASE

No	Work Programme	2020	2021	2022	2023	2024	Stakeholders
1.	Suggest to consider listing of SOEs as Islamic IPOs on AIX.						AIFC Authority, AIX, Samruk Kazyna, Baiterek
2.	Suggest to consider the issuance of sovereign <i>Sukuk</i> in local currency.						AIFC Authority, AIX, Ministry of Finance
3.	Suggest to consider the issuance of sovereign <i>Sukuk</i> in foreign currency.						AIFC Authority, AIX, Ministry of Finance
4.	Suggest to consider the issuance of corporate <i>Sukuk</i> in local currency by SOEs.						AIFC Authority, AIX, Samruk Kazyna, Baiterek
5.	Suggest to launch Islamic Index on AIX.						AIFC Authority, AIX
6.	Suggest to establish regional database of SMEs to attract private equity players.						AIFC Authority
7.	Suggest to attract presence of the regional family offices and foundation in AIFC offering global investments opportunities with attractive taxation arrangements.						AIFC Authority, ABC
8.	Suggest to develop diverse legal frameworks for Islamic trusts and foundations including <i>waqf</i> -based structures ²⁴ .						AIFC Authority, AFSA

²⁴ We note that the AIFC has adopted foundation and trust regulations in 2019. Moving forward, there should be provisions on Shari'ah governance in the regulations to regulate Islamic foundations and trusts.

9.	Suggest to promote regional Belt and Road infrastructure project financing in AIFC through issuance of <i>Sukuk</i> or other Islamic infrastructure funds targeting international investors including Chinese institutions.						AIFC Authority, AIX
10.	Suggest to establish help desks and appropriate guidance to AIFC participants on the offering of products and services beyond AIFC.						AIFC Authority

4.4.3 STRATEGIC INITIATIVE 3 EXPAND INTERNATIONAL CONNECTIVITY AND REGULATORY LINKAGES

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish mutual recognition agreement (MRA) with identified jurisdiction for the offering marketing and distribution of Islamic products.						AIFC Authority
2.	Suggest to expand attractive DTAs with external jurisdictions with extension to AIFC.						AIFC Authority, Ministry of National Economy, Ministry of Finance, Ministry of Foreign Affairs
3.	Suggest to develop facilitative registration framework for the offering, marketing and distribution (OMD) of foreign Islamic funds in AIFC to allow Undertakings for the Collective Investment in Transferable Securities (UCITS) funds in AIFC.						AIFC Authority, AFSA

4.4.4 STRATEGIC INITIATIVE 4 PROMOTE ISLAMIC FINANCE AS VALUE-BASED FINANCE AND INVESTMENTS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider development of SRI <i>Sukuk</i>						AIFC Authority, AFSA

	Framework including green <i>Sukuk</i> .						
2.	Suggest to establish green finance/green <i>Sukuk</i> financial incentive scheme.						AIFC Authority, AFSA
3.	Suggest to consider development of guidance/standards on SRI funds.						AIFC Authority, AFSA
4.	Suggest to consider development of framework for the application of <i>waqf</i> in Islamic capital market in particular Equity, Islamic Funds and <i>Sukuk</i> ²⁵ .						AIFC Authority, AFSA

4.4.5 STRATEGIC INITIATIVE 5 AIFC AS A REFERENCE POINT FOR ISLAMIC FINANCE DEVELOPMENT, STANDARDS AND INNOVATION

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish a dedicated Islamic thought leadership platform with annual flagship event, such as an international conference.						AIFC Authority
2.	Suggest to establish Visiting Scholars Programme.						AIFC Authority
3.	Suggest to establish Graduate Training Programme on Islamic Finance for Kazakhstan and the region.						AIFC Authority
4.	Suggest to consider recognition of impact from AIFC's and region's Islamic finance initiatives in Kazakhstan and the region through prestigious awards, for example from the AIFC Governor or President.						AIFC Authority

²⁵ To include Shari'ah governance framework.

CHAPTER 5: ISLAMIC BANKING

5.1 INTRODUCTION

Kazakhstan has a two-tiered banking system with the NBK in the first tier, which reports to the President of Kazakhstan. The NBK oversees the national monetary policy. The second tier comprises of 28 commercial banks, including 1 state-owned bank, and 13 banks with significant foreign participation (including two full-fledged Islamic banks).

Decree was issued by the President of the Republic of Kazakhstan dated 11 November 2019 №203 "On further improvement of state administration system of the Republic of Kazakhstan", a new state body of the Republic of Kazakhstan, the Agency for Regulation and Development of the Financial Market of the Republic of Kazakhstan ("ARDFM"), has been operating since January 1, 2020.

ARDFM is a state body, which contributes to the stability of the financial system and the development of the financial market, carries out state regulation, control and supervision of the financial market and financial organizations, as well as other people within their competence.

According to the ARDFM, as of March 2020, the value of total banking assets in Kazakhstan is KZT26.73 trillion (US\$69.9 billion), and the share of Islamic banks in total assets is KZT55.5 billion accounting for 0.2% of total banking assets²⁶. Currently, there are two Islamic banks operating in Kazakhstan namely, Abu Dhabi's Al Hilal Bank, established in 2010, which offers both corporate and retail services, and Zaman Bank – converted from conventional bank into Islamic bank in the year 2017. In total, there are five domestic branch offices of Islamic banks in Kazakhstan with 177 employees. 91% of these two banks' financing is structured based on commodity *murabahah/tawarruq* contracts, 8.5% is on *ijarah/ijarah muntahia bittamleek*, and a very small share is based on *wakalah* contract. The distribution of returns on financing has a similar pattern. Major economic activities financed by Islamic banks are wholesale and retail trade, construction, transportation and storage, the supply of electricity, gas, steam and air-conditioning, mining and real estate activities.

As of March 2020, the share of two Islamic banks in total domestic banking assets - Al Hilal Bank and Zaman Bank – was 0.13% (KZT35.29 billion) and 0.08% (KZT20.21 billion), respectively (ARDFM, March)²⁷. Almost half of these total assets are financed by own capital, for example capital to total assets ratio is 52% and 61%, respectively. Both banks had positive earnings (3.97% and 0.26%), respectively. Al Hilal Bank recognised these accounts as off-balance sheet items even these accounts are unrestricted.

AIFC created a favourable legal and regulatory environment on Islamic banking, including Islamic Finance Rules and Islamic Banking Business Prudential Rules (IBB). These rules are based on the standards and guidelines issued by the Islamic Financial Services Board on Capital adequacy, the Basel Accords and the Basel Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision. The capital requirements for the Islamic banks at the AIFC is US\$10 million. AFSA has issued a Notice "AFSA-Q-OA-2020-0028 ON MODIFICATION" on 24th September 2020, that sets the base capital requirement: (a) for an Islamic Bank – US\$5 million. The notice comes into effect from 1 November 2020 and remains effective until 1 November 2023.

The Islamic Bank Al Rayan (subsidiary of Al Rayan Investment LLC) and branch of local Zaman bank have received a certificate of registration with the AIFC.

²⁶ As of 01/03/2020, the exchange rate was 381.86 KZT per 1 USD.

²⁷ ARDFM, "Information about Owned Capital, Liabilities and Assets", March 2020. Available at: <https://nationalbank.kz/?docid=667&switch=english>

5.2 ISSUES AND CHALLENGES

Throughout the last decade Al-Hilal Bank and Zaman Bank remain to be the only Islamic banks operating in the country, and Al-Hilal has been focusing mainly on the corporate banking activities instead of retail²⁸. Not surprisingly, up until now the Islamic banking share in the total banking system assets is very low at less than 1%.

Al-Hilal Bank's decision to focus on corporate banking segment means it does not finance the general population or SMEs. Thus, an extremely small volume of financing together with a relatively narrow business focus makes Islamic banking invisible to the majority of the country's population. In such a scenario, even if there is demand for retail products by the locals, currently there is no Islamic bank which can meet such a demand. Additionally, Al-Hilal Bank has not yet expanded into the AIFC. With only Zaman Bank and Al Rayan bank having recently concluded their registration with the AIFC, the market in the AIFC for Islamic banks is still at a pre-operation stage.

Pursuant to the Roadmap IF2020, throughout 2011-2015 various amendments were made to the legal and regulatory framework on Islamic banking in Kazakhstan to facilitate the issuance of sovereign and corporate Islamic securities, harmonize tax treatment of some Islamic financial products, implement *takaful* and Islamic leasing within the financial system, as well as to allow a conventional bank to be converted into an Islamic one. Arguably, such staggered and piece-meal approach in ensuring that the Islamic banking law and regulations are up-to-standard have caused further uncertainties and contributed to slower growth of the Islamic banking sector, as the market would most likely prefer to wait for all the relevant changes to have taken place, before firming up any decision to enter into the Islamic banking business.

Alternatively, the AIFC has set in place a rather extensive Islamic banking framework. However, it remains untested as to how this framework will work alongside and interface with the local jurisdiction of Kazakhstan as it remains at a nascent stage. Currently, the scant presence of local banks in the AIFC further fuels this uncertainty. Another gap is in the formation of an Islamic banking window within the AIFC. Currently under the AIFC's legal framework, a conventional bank may open an Islamic window, however as per our FGDs, some participants are unsure if they may do so if their local home jurisdiction does not allow the formation of Islamic windows²⁹.

It would be an advantage for the industry if a large and influential financial institution such as Halyk were to signal strong interest in Islamic finance and open an Islamic banking window. Halyk Finance is current the largest bank in Kazakhstan with assets totalling KZT9,059,149 million and its foreign into Islamic banking would attract significant interest from other industry players. Another potential player would be the Housing Construction Savings Bank of Kazakhstan JSC (HCSBK). It is a subsidiary organization of Baiterek National Management Holding JSC. HCSBK implements the system of housing construction savings, which is aimed at improvement of population housing conditions through attracting money of depositors to housing construction deposits and providing them with housing loans. With total banking assets of KZT1.1 billion, the bank has the potential to offer Islamic financing products to its customers and increase Islamic banking market share in the country.

Notably, the absence of any local Islamic bank, with the exception of Zaman Bank, which has a substantial foreign shareholder in the form of ICD, combined with a relatively high entry barrier in the form of minimum capital required for banking licence in Kazakhstan,³⁰ could be taken by foreign Islamic banks/Islamic investors

²⁸ However, we note that Al Hilal Bank has begun to introduce new products for the retail sector in 2018-2019 the response for which has been overwhelming.

IBB - https://afsa.aifc.kz/files/legals/130/file/ibb_v2_fr00014_11.05.2020.pdf

²⁹ In Malaysia, CitiBank (Malaysia) and Deutsche Bank (Malaysia) and United Overseas Bank (M) Bhd operate an Islamic banking windows. In the United Kingdom, United Bank (UK), HSBC, StandardChartered (UK), Barclays Capital operate an Islamic banking windows.

³⁰ Minimum cap requirement (MCR) for banking licence in Kazakhstan is KZT10b = US\$25,765,450. In the AIFC, it is US\$10m. Among its neighbours, the MCR in Uzbekistan is UZ\$100b=US\$10,561,313; in Kyrgyz is KYS600m=US\$8,594,425; in Tajikistan is TJS50m=US\$ 5,159,170. Even for Russia the MCR is only RUR300m=US\$4,746,000 for a basic banking licence and RUR1b=US\$15,820,000 for a universal banking licence. Hence, Kazakhstan's US\$25m MCR is arguably expensive and uncompetitive. On the contrary, Labuan (in Malaysia) banking licence has MCR of RM10m=US\$2.5m; similar to an international Islamic banking licence which has MCR of RM10m=US\$2.5m only.

as an indication that Kazakhstan is not very keen on, does not have sufficient appetite for Islamic banks, or is just not ready for Islamic banking despite all the previous initiatives by the government. Based on the experience in jurisdictions such as Malaysia, Oman and Saudi Arabia, a stronger political will to support the growth of Islamic banking by mobilising government owned banks to operate as Islamic banks, or maybe participate as windows in the AIFC, and state-owned enterprises to use Islamic banking facilities for their banking requirements including by issuing and subscribing to *Sukuk* would result in a substantial increase of the overall Islamic banking market share in Kazakhstan.

A breakdown of the identifiable issues of the Islamic banking sector in Kazakhstan and the challenges in participating in the AIFC is highlighted as follows:

5.2.1 CONVENTIONAL BANKS CANNOT OPERATE ISLAMIC 'WINDOWS' WHICH WOULD HAVE ENABLED A STAGE-BY-STAGE PARTICIPATION INTO ISLAMIC FINANCE

Based on the "Law on Banks and Banking Activities", conventional banks are not allowed to offer or operate any Islamic banking through Islamic windows. This restriction presents a hindrance to interested banks from experimenting with Islamic banking services with their existing and established customer base. Local banks are also not able to open windows in the AIFC, as the AIFC only allows the opening of windows by institutions which are allowed to do so by their home jurisdictions.

We are aware that generally, among the reasons why a regulatory and supervisory authority would be reluctant to permit the operation of Islamic "windows" within conventional banks are due to concerns over "bank within a bank" activities, which may lead to, among others: lack of transparency in capital and risk management; commingling of conventional and Islamic funds; and excessive risk-taking on the basis of profit-sharing investment accounts ("PSIA").

This concern is especially understandable when the regulatory and supervisory authority itself does not have adequate resources in terms of the required tools, skills and competence to supervise such Islamic windows operations and does not have a specifically empowered and active Islamic finance department such as it is currently the situation in Kazakhstan.

5.2.2 LACK OF A DEDICATED ISLAMIC FINANCE DEPARTMENT IN KAZAKHSTAN'S FINANCIAL SERVICE REGULATOR

Based on the organisational chart of the ARDFM, it appears that there is no dedicated "Islamic Finance Department" within the ARDFM set up.

There was an "Islamic Development Division" in the NBK set up in 2014. However, since the establishment of the AIFC in 2018, it is noticeable that many of the officers who used to work at the Islamic Development Division of the NBK have moved to the AIFC; and the latest status of the Islamic Development Division has become less clear since then. This lack of clarity naturally has trickled down to market sentiments.

5.2.2 ISLAMIC BANKS ARE NOT COVERED UNDER THE NATIONAL DEPOSIT INSURANCE SCHEME

Based on the "Law on Banks and Banking Activities", Islamic banks are not covered under the deposit insurance scheme. This lack of coverage is a universal problem for Islamic banking in both Kazakhstan and the AIFC.

In a framework where the conventional banks are covered under the deposit insurance scheme while the Islamic banks are not, an opportunity for regulatory arbitrage by Islamic banks may arise, and public confidence in depositing funds with Islamic banks is reduced.

5.2.3 ONE-SIZE-FITS-ALL ENTRY BARRIER FOR NEW BANKING PLAYERS IN KAZAKHSTAN

The “Law on Banks and Banking Activities” sets the minimum capital of a bank regardless whether a conventional bank or Islamic bank, to be at US\$26.2 million. In March 2016, the NBK reduced the capital requirement for foreign entities with long-term credit ratings of "A" and higher to a lesser minimum capital by half, i.e. US\$15.2 million.

Clearly this requirement means that any party interested to establish an Islamic bank in Kazakhstan would have to commit at least US\$30-35 million for establishing such a new Islamic bank in Kazakhstan with reasonable branch network coverage. If one includes the medium-term direct and indirect expenses; associated with setting up and developing the new bank entity, it would be reasonable to expect the expenses and costs to reach well above US\$50 million within the first 3-year budget framework (which is a minimal planning period in the business plan). As the new entity will have no clients and no funding at the initial period, one has to add up the associated funding and financing costs.

In practical terms, the bank ownership requirements set by the regulator may restrict potential domestic new entrants to this market. Foreign Islamic banks would observe that even amongst the local banks, none has any firm experience or ambition to embark on Islamic finance business. Collectively, there are no proven business models, risk appetite, and qualified staff and Islamic banking and finance professionals who are able to form the team, argue and convince the management, directors and shareholders to champion the setting up of the new banking entity and commit the required funds. These concerns could be mitigated if banks could initiate their foray into Islamic finance business via an Islamic banking window, but the latter structure is not allowed by the current legal framework.

5.2.4 FIXED SCOPE OF PRODUCTS

By virtue of the “Law on Banks and Banking Activities” and “Law on Financial Lease”, the Islamic finance products which may be offered in Kazakhstan includes mobilisation of savings based on *qard ḥasan* and *muḍarabah*, financing based on *qard ḥasan*, *murabahah* and commodity *murabahah*, financing through *muḍarabah* and *musharakah*, financing based on *ijarah*, and the use of *wakalah* for the Islamic bank’s banking transactions. Islamic banks may also carry out the above-mentioned operations together with some other types such as currency exchange (*sarf*), transfer transactions (*hawala*) etc., which do not contradict the Shari’ah. *Istisna’* and *salam* are also recognized as the law describes that an agreement between an Islamic bank, as a commercial agent, and a seller, as a producer or manufacturer of goods, may provide immediate partial or full prepayment of goods purchased under the condition of delivery of the goods within the period stipulated by the parties. Rules as applicable to a construction agreement or agricultural procurement contract are similarly applied to regulate the relationship between an Islamic bank and a manufacturer or producer.

As many Islamic banks outside Kazakhstan uses *tawarruq* arrangements both for fund mobilisation and for financing, it is important that, the law explicitly recognizes *tawarruq* to keep up with the development of global Islamic banking practices. It is also important that the law explicitly accommodates and facilitates all range of Shari’ah underlying contracts which are regularly used by Islamic banks, which have so far not been covered therein, including *diminishing musharakah*, *hibah*, *ijarah mawsufah fi zimmah*, *kafalah*, *qard* (other than *qard hassan*), *rahn*, *wadiyah* and *wa’d*. It is important to address these gaps as they hinder operations into Kazakhstan’s business sectors.

5.2.5 LACK OF ISLAMIC BANKING PARTICIPANTS

It is clear that having only 2 Islamic banks in the form of Al-Hilal Bank and Zaman Bank so far would not position Kazakhstan (and the AIFC) as a vibrant Islamic finance market. There is a need to seriously consider measures to increase the quantity and diversity of players in the Kazakh Islamic financial industry to support a wider range of financial products and services that serves the best interest of Kazakhstan and its people.

A well-planned entrance of new players would enable Kazakhstan and the AIFC, among others, to:

- (i) accelerate the expansion of Islamic banking business in parallel with their relatively advanced conventional counterparts; and
- (ii) inject greater market competition in terms of pricing, product innovation, customer service and operational efficiency.

5.2.6 LACK OF KEY SUPPORTING INFRASTRUCTURES

In order to ensure that the Islamic banking industry is able to develop in a stable and sustainable manner, new supporting infrastructures should be established, particularly supporting infrastructure to facilitate liquidity instruments and liquidity management, recovery, restructuring and resolution of Islamic banks, crisis-management, and access to lenders-of-last-resort facilities (“LOLR”).

The Bank of England has been working on a fund-based deposit model that would help Islamic financiers to meet regulatory requirements for liquid asset buffers. This proposed Shari’ah compliant liquidity tool will be offered to a wider range of financial institutions beyond Islamic banks to boost demand. In Malaysia, the financial safety net framework encompasses LOLR facilities and a comprehensive deposit insurance system that provides coverage for both conventional and Islamic deposits.

In order to convince more players to enter the Kazakhstan Islamic finance market, there is a need for the government and the regulatory and supervisory authorities to assure players that new supporting infrastructures will be initiated and established. These supporting infrastructures can be developed over the course of several years; however, the government and the regulatory and supervisory authorities need to show firm commitments by way of concrete efforts and clear timelines in putting them in place.

These include supporting infrastructures for:

- a) liquidity instruments and liquidity management; particularly an Islamic interbank money market and a commodity trading platform;
- b) recovery, restructuring and resolution of Islamic banks; particularly by reviewing the corporate insolvency and bankruptcy laws in Kazakhstan and revising them as necessary to accommodate the specificities of business models of Islamic banks;
- c) crisis-management; particularly in the form of a national asset management company, which would be capable of taking over non-performing financing portfolios from Islamic banks, and a national capital injection company, which would be capable of supporting Islamic banks with short term capital support amidst scarcity of capital during a crisis; and
- d) LOLR facilities; particularly in the form of Shari’ah compliant instruments issued by the NBK to Islamic banks so that they would have equal access to LOLR facility just like their conventional counterparts in the situation of a bank-run.

5.3 SHARI’AH GOVERNANCE

The laws in mainland Kazakhstan which enable Islamic banking, the offering of Islamic securities, *takaful* and leasing have laid out the minimum requirements for Shari’ah governance and supervision for Islamic financial institutions such as the Shari’ah committee or Shariah supervisory board, referred to as the “Council on Islamic Financing Principles”. This Council is an independent one comprising of experts appointed by the general meeting of shareholders and its main task is to guide the institutions on their transactions and activities and ensure their compliance with Shari’ah principles.

However, we recommend that this minimum requirement of the existence of a Shari’ah committee be augmented as follows through the issuance of regulations or guidelines from the ARDFM:

1. The requirement to conduct a Shari'ah review or audit at least once every financial year for an independent assessment of the institution's state of Shari'ah compliance. The Shari'ah committee and Shari'ah audit are the two core components of any Shari'ah governance system. With a Shari'ah audit, stakeholders will have the assurance that the Islamic financial institution has implemented the Council's decisions and resolutions and ensured Shari'ah compliance in its services and transactions.
2. The requirement that an Islamic financial institution is to establish, implement and maintain policies, procedures, systems and controls that ensure that its business is conducted in a Shari'ah compliant manner. Such policies and procedures include those ensuring the criteria for the appointment and assessment of Council members as well as its effective functioning.
3. The application of the AAOIFI and IFSB standards on governance, Shari'ah governance, Shari'ah principles and risk management as the minimum requirements and best practice for the Islamic financial institution.

The ARDFM may consider the establishment of a central Shari'ah board or authority, similar to the AIFC Central Shari'ah Advisory Board. Such a central Shari'ah council may act as a guide on Shari'ah matters, in particular for advising on guidelines and regulations involving Shari'ah matters or when the industry players are faced with a highly disputed Shari'ah issue. A central Shari'ah council could provide the minimum requirements on a particular issue and authoritative, definitive guidance to industry players with which they could move forward with products and transactions. The ARDFM may decide if they wish the resolutions of the central Shari'ah council to bind the market players, as is the position in jurisdictions such as Malaysia, or if they ought to become a reference only for the industry only.

5.4 RECOMMENDATIONS

The recommendations set out below would be facilitated by an Islamic finance department within the regulators who are dedicated to studying the requirements of an Islamic banking operation and how to supervise both banking windows and full-fledged operations.

Strategic initiatives	Recommendations
1. Conventional banks in Kazakhstan to be allowed to operate Islamic 'windows' subject to additional prudential and Shari'ah requirements.	<ol style="list-style-type: none"> i. Allow the operations of Islamic banking windows in Kazakhstan; ii. Introduce specific regulatory and prudential framework for Islamic windows; and iii. AIFC to introduce a framework and allow opening of Islamic banking window from any jurisdiction.
2. Islamic banks to be covered under the Deposit Insurance Scheme.	<ol style="list-style-type: none"> i. To establish a national deposit insurance/<i>takaful</i> scheme as a counterpart to the national deposit insurance scheme; and ii. To amend the existing legislation to place Islamic banks under a national deposit insurance/<i>takaful</i> scheme.
3. Establishment of an Islamic finance Department in the regulatory authorities.	<ol style="list-style-type: none"> i. Establish a dedicated Islamic finance department in each relevant regulatory and supervisory authority in Kazakhstan; ii. Conduct joint training exercises with other regulators to increase knowledge and competency; and

	iii. Coordinate with other regulatory authorities to remove uncertainty and ambiguity on regulatory, tax and other policy matters.
4. Lowering entry barriers for new players to add diversity and depth in the market.	i. Introduce a wider range of licenses for Islamic banks depending on varying type of banks.
5. Expanding products eligibility to add diversity and depth in the market.	i. Review the existing national law to expand the applicable Shari'ah principles.
6. Encouraging more players to add diversity and depth in the market.	i. Establish and implement a well-planned entrance of new players.
7. Establishing supporting infrastructures to ensure stability and sustainability.	i. Establish supporting liquidity management infrastructure for Islamic banking; and ii. Establish supporting crisis management infrastructure for Islamic banking.

5.4.1 STRATEGIC INITIATIVE 1 CONVENTIONAL BANKS IN KAZAKHSTAN TO BE ALLOWED TO OPERATE ISLAMIC "WINDOWS" SUBJECT TO ADDITIONAL PRUDENTIAL AND SHARI'AH REQUIREMENTS

(i) Allow the operations of Islamic banking windows in Kazakhstan

To encourage the participation of local banks in its Islamic finance sector, Kazakhstan should establish a legal and regulatory framework that permits the offering and operation of Islamic windows by conventional banks since this would enable, among others:

- a) the lowering of the cost of entry and therefore allows for a faster and more efficient development of market share of the Islamic banking sector in Kazakhstan, as has been evident in many jurisdictions (such as Malaysia and Oman);
- b) offer wider options to both the institutions and the consumer; as:
 1. conventional institutions would obtain easier and faster access to the Islamic markets without having to start from scratch in terms of creating separate/new entities and team; while
 2. customers would have wider brand-recognition and loyalty options – in particular for those customers who want to use Islamic finance but prefer to remain with financial institutions they are already very familiar with, instead of being forced to move to a new and untested financial institution); and
 3. any concerns over "shadow banking" related issues can be addressed through proper law and regulations as well as supervision, as per the experience in many countries which have successfully implemented the Islamic "windows" model.

Other regulatory and supervisory authorities which have permitted Islamic windows and successfully expedited the growth of their respective Islamic banking sector include those in Afghanistan, Bahrain, Indonesia, Malaysia, Oman, the UAE and the UK. In Malaysia and Oman for example, the operation of Islamic "windows" grew faster than full-fledged Islamic banks, to the extent the largest Islamic windows in

Malaysia (namely, Maybank)³¹ and in Oman (namely, Meethaq of Bank Muscat) were even larger than any other full-fledged Islamic banks in the respective countries.

Qatar has only banned the operation of Islamic windows beginning from 2012, however, this decision was made primarily in favour of pushing for stronger presence and market-share of full-fledged Islamic banks upon achieving the desired Islamic banking size, and was not because of irreconcilable prudential/consumer concerns.

(ii) Introduce specific regulatory and prudential framework for Islamic windows

The ARDFM should consider taking guidance from the IFSB Standard no. 17 on Core Principles for Islamic Finance Regulation” (Banking Sector), in particular CPIFR 32 on Islamic windows as a relevant benchmark for the prudential standards.

(iii) The AIFC to introduce a framework and allow opening of Islamic banking window from any jurisdiction

The opening of Islamic windows has already been implemented in the AIFC. However, the AIFC has indicated to us that they would only allow the opening of windows by institutions which are allowed to do so by their home jurisdiction. Such a restriction will only hamper participation. It is proposed that the AIFC reconsiders this matter and introduces a framework whereby the AIFC allows the opening of Islamic banking windows from all and regardless of the bank’s home jurisdiction.

5.4.2 STRATEGIC INITIATIVE 2 ISLAMIC BANKS TO BE COVERED UNDER DEPOSIT INSURANCE SCHEME

(i) To establish a national deposit insurance/ *takaful* scheme as a counterpart to the national deposit insurance scheme

As already mentioned above, it is lamentable that Islamic banks both in Kazakhstan and the AIFC are not covered under the national deposit insurance scheme. Islamic banks should also enjoy coverage under a national deposit protection scheme, as this would among others, level the playing field between the conventional banks and Islamic banks and minimise room for regulatory arbitrage, increase public confidence in the competitiveness of Islamic bank, and add more depth to deposit insurance schemes in Kazakhstan (and the AIFC) by its ability to offer Shari’ah compliant (*takafu*like) protection to consumers/depositors. Both Kazakhstan and the AIFC should look forward to introducing a Shari’ah compliant deposit protection structure in the future if it seeks to promote further development and also allay any fears by local banks looking to offer Islamic deposit products.

Unsurprisingly, many other central banks or regulatory and supervisory authorities have included Islamic bank deposits within their own national deposit insurance scheme or have devised a Shari’ah compliant deposit protection scheme, such as by introducing a *takaful* equivalent, such as in Bahrain, Malaysia, Nigeria and Sudan.

(ii) To amend the existing legislation to place Islamic banks under a national deposit insurance/ *takaful* scheme

In the immediate future, it is advisable that Kazakhstan and the AIFC amend the existing laws to place Islamic banks under the national insurance scheme while an appropriate national deposit protection scheme is being developed. Both the ARDFM and AFSA may benefit from the ongoing developments by the IFSB in developing a set of Core Principles for Islamic Finance Regulation (Effective Islamic Deposit

³¹ Only in 2008 Maybank’s Islamic window “Maybank Islamic” started its operation as a full-fledged Islamic bank upon a successful conversion.

Insurance System) which, once completed, would be a relevant benchmark for the prudential standards with regards to an Islamic deposit protection scheme to be integrated into their respective legal and regulatory frameworks.

5.4.3 STRATEGIC INITIATIVE 3 ESTABLISHMENT OF AN ISLAMIC FINANCE DEPARTMENT IN THE KAZAKHSTAN'S FUTURE REGULATOR FOR FINANCIAL SERVICES

(i) Establish a dedicated Islamic finance department in each relevant regulatory and supervisory authority in Kazakhstan

A fully dedicated Islamic finance department within the regulatory and supervisory authority is very important as it would enable, among others:

- a) closer, more focused and dedicated attention for accurate policy-development, monitoring and supervision of the development of the Islamic banking sector in Kazakhstan;
- b) capacity building on the part of the team at the regulatory and supervisory authority capable of monitoring and supervising a faster-growing Islamic banking sector in Kazakhstan with the adequate skills and competence, especially in view of the cross-sectoral approach and specificities of Islamic finance which require additional skills and competence from the regulatory and supervisory authority; and
- c) better coordination and planning in the establishment of market infrastructure relevant for the development of Islamic banking, especially issuance of Shari'ah compliant central bank instruments; and the establishment of Islamic interbank money market – both to facilitate the reserve and liquidity management by Islamic banks.

A dedicated Islamic finance department within the regulatory and supervisory authority would be able to highlight issues and provide all the necessary support and requirements as may be relevant and applicable for this specific sector within the Kazakhstan financial system. Such Islamic finance department should be provided with appropriate resources including clear mandate, sufficient funding, competent man-power and structured capacity building.

Other jurisdictions which have dedicated Islamic finance departments within their respective financial regulators include Indonesia, Lebanon, Malaysia, Pakistan and Oman. It is duly noted that the AIFC has its own Islamic finance team which clearly has been provided with appropriate resources including clear mandate, sufficient funding, competent man-power and structured capacity building, resulting in focused development measures. It is very appropriate that the same dedicated resource is implemented in mainland Kazakhstan.

(ii) Conduct joint training exercises with other regulators to increase knowledge and competency

Upon the establishment of a dedicated Islamic finance, continuous development in capability and capacity should be undertaken while capitalizing on opportunities to build linkages and fostering closer ties with other jurisdictions that have the necessary experiences in supervising Islamic banking and banking windows. These linkages will bring about a secondary benefit of forging greater business ties and greater industry exposure. The established finance departments in ARDFM and AFSA can conduct joint training exercises which will allow the sharing knowledge and experience among their officers while building much needed knowledge, skillset and competency.

5.4.4 STRATEGIC INITIATIVE 4 LOWERING ENTRY BARRIER FOR NEW PLAYERS TO ADD DIVERSITY AND DEPTH IN THE MARKET

(i) Introduce a wider range of licenses for Islamic banks depending on varying type of banks

The ARDFM and AFSA should consider granting licences for a wider range and type of Islamic banks at a lower entry barrier/cost. For example, the imposition of different minimum capital requirements can be applied to full-fledged localised Islamic banks in comparison to international Islamic banks, which only deals in foreign currency transactions and international currency business units (ICBU) of an existing bank.

Various other central banks or regulatory authorities already have different minimum capital requirements for different types of Islamic banking operations such as Malaysia under its Malaysia International Islamic Financial Centre (MIFC) initiatives. For example, the requirements set in Malaysia are such that as long as the applying institutions are:

- a) Well-established and reputable licensed financial institutions;
- b) Adopted international banking practices formulated by the Bank for International Settlements (BIS) or any other international standard-setting body(ies) or international insurance practices set by the International Association of Insurance Supervisors or any other international standard-setting body, or adopts any other international best practices in the financial services related industry (as the case may be);
- c) Regulated and supervised by a competent home regulatory authority; and
- d) Possesses a sound track record;

the applying institution can apply to operate as an incorporated entity or a branch a minimum paid-up capital of RM10 million (equivalent to approximately US\$2.5 million) only with an annual licensing fee amounting to RM50,000 (equivalent to approximately US \$12,500) only for banks.

These requirements present a lower and more attractive cost structure for new Islamic bank entrants and more importantly new types of Islamic banks within both the AIFC and Kazakhstan. Such a policy will do much for the development of Islamic banking and banking for Kazakhstan and in turn will lead to more domestic bank participation into the AIFC, as the closest regional financial hub.

5.4.5 STRATEGIC INITIATIVE 5 EXPANDING PRODUCTS ELIGIBILITY TO ADD DIVERSITY AND DEPTH IN THE MARKET

(i) Review existing national law to expand the applicable Shari'ah principles

In relation to mainland, Kazakhstan in particular, it is proposed that, there be a review of the existing law to ensure that Shari'ah principles other than those already explicitly allowed may be applied by Islamic banks, as long as prior endorsement/approval has been obtained from their "Councils on Islamic Finance Principles".

5.4.6 STRATEGIC INITIATIVE 6 ENCOURAGING MORE PLAYERS TO ADD DIVERSITY AND DEPTH IN THE MARKET

(i) Establish and implement a well-planned entrance of new players

Ultimately, a holistic strategy is needed to establish and implement a well-planned entrance of new players which would enable Kazakhstan and the AIFC, among others, to:

- accelerate the expansion of Islamic banking in parallel with their relatively advanced conventional counterparts; and
- inject greater market competition in terms of pricing, product innovation, customer service and operational efficiency.

The measures that ought to be taken as soon as possible include:

- a) Issuing of new Islamic banking licences to institutions with specialised expertise. An 'auction' approach can be carried out whereby the regulatory and supervisory authority may announce the number of licences to be made available and the minimum conditions for applicants.
- b) Expanding the business scope of qualified international Islamic banks. The recommendations outlined above on lower licensing requirements for players who deals in foreign currencies only.

Financial regulatory authorities such as those in Bahrain, Malaysia, the UAE and the UK have enabled a diversified range of financial institutions within their markets due to the availability of different types of licences to undertake niche areas of financial intermediation. Their markets are not restricted to the licensing commercial banks and insurance companies only.

5.4.7 STRATEGIC INITIATIVE 7 ESTABLISHING SUPPORTING INFRASTRUCTURES TO ENSURE STABILITY AND SUSTAINABILITY

(i) Establish supporting liquidity management infrastructure for Islamic banking

It is recommended that the NBK and/or the ARDFM undertake a review of the relevant laws especially the "Law on the National Bank of the Republic of Kazakhstan" and the "Law on Banks and Banking Activities" to ensure that it has the capability of establishing the necessary supporting infrastructures in particularly those to facilitate liquidity instruments and liquidity management. Both the ARDFM and the AIFC should consider establishing a liquidity infrastructure for Islamic banking such as an Islamic interbank money market and a commodity trading platform (akin to the Bursa Suq as-Sila' of Malaysia) as a liquidity management tool which will have a spill-out effect into the industry. Such an infrastructure might mitigate the issue of local Islamic banks having to constantly utilize foreign platforms for their operations and liquidity management, a necessity which exposes the economy to currency risks.

(ii) Establish supporting crisis management infrastructure for Islamic banking

Over the past decade, the banking sector both globally and in Kazakhstan has seen some uncertainties. These uncertainties look set to continue with the ever-growing number of trade challenges and disputes which will impact Kazakhstan and the AIFC. A pragmatic approach ought to be adopted in pursuit of a sustainable and resilient Islamic banking system. All parties need to collaborate towards the establishment of an Islamic banking crisis management infrastructure to facilitate and support the recovery, restructuring and resolution of Islamic banks. A further dynamic approach will be the establishment of a national capital injection company and access to Shari'ah compliant LOLR facility to cover for any instances of a bank-run.

Further on, plans for the establishment of the supporting infrastructure should be concretised by allocating sufficient resources in terms of budget, man-power and clear mandates under the law and regulations.

5.5 ACTION PLAN

5.5.1 STRATEGIC INITIATIVE 1

CONVENTIONAL BANKS IN KAZAKHSTAN TO BE ALLOWED TO OPERATE ISLAMIC “WINDOWS” SUBJECT TO ADDITIONAL PRUDENTIAL AND SHARI’AH REQUIREMENTS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to allow the operation of Islamic banking windows in Kazakhstan.						AIFC Authority, ARDFM
2.	Suggest to introduce a specific regulatory and prudential framework for Islamic banking windows based on the IFSB Standard No.17 CPIFR 32.						AIFC Authority, ARDFM
3.	Suggest to introduce a framework allowing the opening of an Islamic banking window by a conventional bank from any jurisdiction.						AIFC Authority, AFSA

5.5.2 STRATEGIC INITIATIVE 2

ISLAMIC BANKS TO BE COVERED UNDER DEPOSIT INSURANCE SCHEME

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to amend the existing legislation to place Islamic banks under a national deposit <i>takaful</i> scheme.						AIFC Authority, ARDFM, NBK, AFSA
2.	Suggest to establish a national deposit <i>takaful</i> scheme as a counterpart to the national deposit insurance scheme.						AIFC Authority, ARDFM, NBK, AFSA

5.5.3 STRATEGIC INITIATIVE 3

ESTABLISHING AN ISLAMIC FINANCE DEPARTMENT IN ARDFM AND AFSA

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish a dedicated Islamic finance department in each of the						AIFC Authority, ARDFM, AFSA

	relevant regulatory, supervisory and financial development bodies in Kazakhstan and the AIFC.						
2.	Suggest to conduct joint-training exercises with other regulators who have experience in the supervision of Islamic banking and banking windows to increase the confidence and knowledge of the officers.						AIFC Authority, ARDFM, AFSA

5.5.4 STRATEGIC INITIATIVE 4

LOWERING ENTRY BARRIER FOR NEW PLAYERS TO ADD DIVERSITY AND DEPTH IN THE MARKET

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to introduce a wider range of licenses for Islamic						AIFC Authority, AFSA
	banks depending on the varying types of banks (for example ICBUs, ISBs, Finance Houses, etc).						

5.5.5 STRATEGIC INITIATIVE 5

EXPANDING PRODUCTS ELIGIBILITY TO ADD DIVERSITY AND DEPTH IN THE MARKET

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to review existing national law to expand the applicable Shari'ah principles other than those already explicitly covered by Islamic banks.						AIFC Authority, ARDFM
2.	Suggest to provide a clear mandate and empowerment for the council of Islamic finance principles of each Islamic bank to determine themselves which Shari'ah contracts and principles to apply for operations following global practice.						AIFC Authority, ARDFM, AFSA

3.	Suggest to provide a clear mandate and powers for financial supervisory and regulatory authority to regulate application of Shari'ah principles with guidance from the central Shari'ah board.						AIFC Authority, ARDFM, AFSA
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5.5.6 STRATEGIC INITIATIVE 6 ENCOURAGING MORE PLAYERS TO ADD DIVERSITY AND DEPTH IN THE MARKET

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Introduce an auction approach for issuance of Islamic banking licenses of different types.						AIFC Authority, AFSA

5.5.7 STRATEGIC INITIATIVE 7 SUPPORTING INFRASTRUCTURES TO ENSURE STABILITY AND SUSTAINABILITY

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to review the existing frameworks for capital adequacy, deposit and investment, financing activities and Shari'ah governance to be in line with international standards such as IFSB and AAOIFI.						AIFC Authority ARDFM, NBK
2.	Suggest to establish crisis-management infrastructures such as a national capital injection company and a Shari'ah compliant LOLR.						AIFC Authority, ARDFM, AFSA, NBK

CHAPTER 6: ISLAMIC CAPITAL MARKET

6.1 INTRODUCTION

The current regulatory and supervisory authority of Kazakhstan's capital market is the ARDFM. The capital market of Kazakhstan currently comprises of the equity market, bond market, derivative market and the asset management industry.

KAZAKHSTAN STOCK EXCHANGE (KASE)

Year	Key Milestones
1993	KASE was established and commenced trade in foreign currency
1995	Launch of trade in T-Bills
1996	Launch of derivatives trading
1997	Launch of equity trading
1998	Launch of KaSE "nego" deals system
1999	Launch of new corporate bond trading
2001	Launch of "automatic" repo market
2006	IPO of KazMunayGas Exploration Production
2007	Launch of special trading floor of the Regional Financial Centre of Almaty on the base of KaSE
2011	Creation of a new multifunctional Internet-trading system – "STrade"
2012	Subscription to common shares of KazTransOil JSC (People's IPO)
2014	Subscription to common shares of KEGOC (People's IPO)

Relevant Statistics on KaSE as at January 2020

(i) Professional Participants and Institutional Investors of securities market

As of 1st January 2020, total 73 licences³² were issued for carrying out activities in the securities market of the Republic of Kazakhstan.

In the fourth quarter of 2019 total assets of the professional securities market participants increased by 2.17% amounted to KZT286.8 billion, liabilities increased by 3.9% amounted to KZT73.2 billion and total equity increased by 1.59% amounted to KZT213,5 billion.

(ii) Market capitalization of the equity and bond market as of 1st January 2020

As of 1 January, 2020, the stock market capitalization amounted to KZT17.22 trillion or 26% of GDP, while the capitalization of the bond market as of the same date amounted to KZT12.12 trillion or 18% of GDP.

The capitalization of the shares as of 1 January, 2020, increased by 11.56% as compared to October 1, 2019, and the capitalization of bonds decreased by 0.3% over the same period

In comparison, the world's market capitalization of the domestic listed companies as a percentage of global GDP as at the end of 2018 stood at 92.99%. Even the market capitalization rate at the height of the global financial crisis at a low of 55.97% of GDP is much higher than the combined size of the Kazakhstan's equity and bond market demonstrating that the current state of Kazakhstan's capital market is still developing and carries a good potential for further development and growth given the right conditions.

³² At the same time, according to the Law of the Republic of Kazakhstan "About securities market", the JSC «Central securities Depository» is allowed to carry out activities without a licence.

As of 1 January, 2020, the number of issues of shares and corporate bonds included in the Kazakhstan Stock Exchange JSC (KASE) official list amounted to 138 (21.26% of the total number of securities issues included in the KASE official list) and 256 (39.44%), respectively. Number of government securities issues amounted to 214 (32.97%).

As of 1 January, 2020, the number of total current bond issues amounted to 447 with a total nominal value of KZT16.97 trillion.

According to the World Bank, there is a long-term relationship between stock markets and economies with corporate profits acting as the causal link between market capitalisation and nominal GDP. Based on the World Bank report, developed stock markets tend to converge around a market capitalisation to GDP ratio of between 90% to 120%.

International financial centres such as Hong Kong and Singapore have been able to maintain high market capitalisation to GDP ratios in excess of 300% through their ability to attract foreign listings to sustain expansion in market capitalisation relative to the size of their economies. Internationalisation can also add to market capitalisation growth through domestic companies expanding abroad.

Note however that according to the World Bank, stock market size can also be measured in various ways, and each may produce a different ranking of countries. The development of an economy's financial markets is closely related to its overall development. Well-functioning financial systems provide good and easily accessible information which can lower transaction costs and subsequently improve resource allocation and boosts economic growth. Both banking systems and stock markets enhance growth, the main factor in poverty reduction. At low levels of economic development commercial banks tend to dominate the financial system, while at higher levels domestic stock markets tend to become more active and efficient relative to domestic banks. Open economies with sound macroeconomic policies, good legal systems and shareholder protection attract capital and therefore have larger financial markets.

(iii) Investments by Institutional Investors and Professional Participants in the Capital Market

In terms of participation in the capital market, the total amount of pension assets invested in the securities market in absolute terms equals to KZT9.34 trillion (approximately US\$21.7 billion at the current exchange rate). Out of the total amount, a bit less than half (46,7%) of the pension assets invested in securities are held in the form of government securities worth up to KZT4.3 trillion (approximately US\$10.1 billion). Significantly, 32.7% of the pension assets invested in securities are invested in domestic non-government securities amounting up to KZT3.05 trillion (approximately US\$7.1 billion).

This is even more prevalent by the second-tier banks ("STB") as government securities make up to 68% (approximately US\$9.5 billion) from the STB's total invested assets in the securities market, significantly dwarfing the KZT926 billion (approximately US\$2.1 billion) worth of invested assets held in securities issued by domestic non-government issuers.

A more balanced spread is sighted amongst insurance (and reinsurance) organizations where only 31.73% (approximately US\$596.8 million) of assets are invested in government securities, while 47.3% (approximately US\$890 million) of assets are invested in domestic corporate securities and another 4.5% (approximately US\$84.6 million) is invested in other instruments that are available within the current securities market.

As for the investment tendencies within the securities market by investment funds and professional securities market participants ("PURCBs"), which are overwhelmingly in favour of investing in non-government issued securities. Investment funds advanced about 7% of their total invested assets in the securities market in corporate securities of foreign issuers (approximately US\$27.2 million). Meanwhile, professional participants hold 65% (approximately US\$253 million) of their invested assets in the securities market in the form of local corporate securities, 11.8% in other instruments (US\$46.1 million) and by comparison, hold 12.4% of government securities (US\$48.2 million).

Astana International Exchange (AIX)

AIX was created with the aim of attracting investment in a region where the capital market has historically been underdeveloped and needed rebuilding. Traded securities were few, liquidity low, foreign investment absent – caused by a combination of domestic legislation and regulation, and an economy dominated by government ownership.

As global capital markets evolve, international investors are looking for new opportunities and jurisdictions with a regulated environment that they understand. AIX operates in such an environment – with a legal and regulatory framework familiar to foreign investors, which protects the interests of both investors and issuers.

A fully operational exchange to the highest international standards in 18 months. AIX uses a Nasdaq matching engine that is used on 60 exchanges around the world, have onboarded more than 20 local and international brokers and have a T+2 post-trade infrastructure connected to local and international custodians.

AIX is working to develop liquidity – an obvious must for investors - through a global standard model for custody; securities borrowing and short selling program for market makers; multi-currency settlement; more efficient conversion of GDRs and shares and supporting both maker makers and research providers.

All these initiatives, most of which are the first of their kind in the Central Asian region, will contribute to a more active growth of the capital market for domestic and foreign investors in Kazakhstan and the Central Asian region.

AIX currently has 24 brokers from both Kazakhstan and around the world support both local and frontier market investors.

AIX as of now is off to a good start. Equity capital raised on AIX over the last year is US\$217 million which is several times more than in the last three years in Kazakhstan. Over the past 12 months, the foreign investors market share increased from 0% to 45%. AIX currently has 8 actively traded equities, 9 traded public debt issues, 25 private debt issues listed and 7 exchange traded notes or funds, 5 of which AIX itself listed last year.

To further develop the market, AIX has developed a simplified regulatory framework for smaller, mid-sized Kazakh businesses. Larger businesses can access global markets such as London, but it's obvious that smaller businesses cannot. AIX wants to be able to start to build both retail and small institutional demand for these businesses which are at the core of the Kazakh economy.

There was nothing here 18 months ago. A good foundation has been built, there are 20 or 30 different initiatives at AIX, pieces of a jigsaw puzzle that has been gradually pulled together over the next couple of years to build a vibrant market. Clearly, private sector debt and equity issuance is part of that. It is not going to happen overnight, but AIX is making good progress there.

Notable Highlights:

- On December 10, 2019, iX exchange traded notes ("ETN", "Notes") have been added to the AIX official list. iX ETNs are the first of a broad range of exchange-traded products that are expected to be launched on the AIX.
- On November 19 Citibank Kazakhstan JSC (Citi) became a custodian of the Astana International Exchange Central Securities Depository (AIX CSD). Citi will be offering settlement and safekeeping services for foreign securities trading at AIX.
- AIX and Renaissance Capital, a leading emerging and frontier markets investment bank, held 'Kazakhstan in Focus Day' on 24 October 2019 in London. This specialized regional event brought together Kazakh companies from the aviation (Air Astana), financial (Halyk Bank), oil & gas (KazMunayGas, Nostrum Oil & Gas), retail (Magnum Cash & Carry), telecom (Kazakhtelecom, Kcell), transportation (Kazakhstan Temir Zholy), and metals & mining (KAZ Minerals) sectors as well as

Sovereign Wealth Fund Samruk-Kazyna and more than 30 major international investors, focused on or considering investments in Kazakhstan.

- The largest Chinese investment bank and broker, CITIC Securities Co., Ltd. became a trading member of AIX. CITICS offers a broad range of services including brokerage, investment advisory, and investment banking. CITICS is the first broker from Mainland China to become a trading member of AIX.
- Ordinary shares and GDRs of Halyk Bank JSC were included in the AIX official list effective September 30, 2019.
- On September 26 Kazakhstan Sovereign Wealth Fund Samruk-Kazyna sold 9.86 million GDRs of JSC NAC "Kazatomprom" by way of an accelerated bookbuild through the London Stock Exchange and the AIX.
- On September 24, units of ITI Funds RTS Equity UCITS ETF SICAV were listed. The ETF invests in 40 shares of top Russian companies traded on Moscow Exchange, providing diversified exposure to 12 industries.
- On September 19, AIX introduced Mining Company Rules designed to create favourable environment for mining companies to raise capital.
- On September 18, AIX achieved ISO 27001 certification, which confirms its compliance with global standards for Information Security Management System (ISMS), covering trading, clearing, settlement, registry and depository services. AIX also achieved ISO/IEC 27032:2012 which represents global standards for Cybersecurity. These certificates indicate AIX's commitment towards ensuring a robust framework for Information Security systems and help to develop a greater confidence in the quality and the safety of AIX services.
- On 16 August 2019 units of ITI Funds Russia focused USD Eurobond UCITS ETF SICAV were listed.
- AIX launched mobile application for retail investors "AIX Connect". The application provides users with convenient and quick access to the news of AIX and its listed companies, as well as real-time market data. The application is available to users of Android and iOS smartphones on Google Play and the Apple Store.
- Kazpost JSC and Renaissance Capital investment company became trading members of AIX. It allows to expand access for a large base of retail investors across many regions of Kazakhstan through Kazpost, and by institutions in the region through one of the leading independent investment companies in the frontier and emerging markets.
- Nasdaq's SMARTS Market Surveillance system for real-time surveillance and monitoring of market operations functions was deployed. The set of AIX's SMARTS alerts and reports for surveillance allows AIX, to pro-actively detect abnormal trading patterns (including spoofing, layering, collusion etc.), and to deter market abuse in all types of assets (equities and fixed income). The solution is also scalable and can easily expand to cover future asset classes as required.
- AIX agreed to support the Green Investment Principles (GIP) related to investments and operations in the Belt and Road region. The principles have been announced during the 2nd Belt and Road Forum in Beijing on 25 April. The GIP was developed by China Green Finance Committee and the City of London in collaboration with other reputable international organizations. The GIP aims to build an international network for improving the management of environmental and social risks for investments in the Belt and Road region.
- On 17 April 2019 ordinary shares of the first foreign issuer Polymetal International Plc were listed on AIX.
- AIX CSD became an Associate member of the European Central Securities Depositories Association (ECSDA). ECSDA represents 40 national and international central securities depositories (CSDs) across 36 European countries.
- AIX selected KELER CCP and KELER CSD to provide a full suite of post-trade services to AIX's members for equity clearing and settlement. KELER CSD is a central securities depository and a financial institution, while KELER CCP is a licensed central counterparty together with more than 25 years of experience, providing harmonized services and connections to all major securities markets.
- On March 2020 WOOD & Co became a trading member of AIX.
- On March 2020, the first cross listing at AIX of Sukuk issued by Qatar International Islamic Bank (QIIB) with primary listing on the London Stock Exchange (LSE) in the amount of US\$500 million with a spread of 175 basis points over the 5-year mid swaps carrying a fixed coupon of 4.264% per annum.

6.2 ISSUES AND CHALLENGES

6.2.1 NON-EXISTENT ISLAMIC CAPITAL MARKET AND CONDUCTIVE ECOSYSTEM

Kazakhstan capital market is generally underdeveloped in both its equity and debt capital market. Further, its capital market is characterized by the non-existence of an Islamic capital market despite the presence of legal frameworks for its Islamic products and services. The challenges are further compounded by the absence of a conducive ecosystem to help facilitate the capacity for fund-raising and investments, expansion of product and services, development of a robust regulatory framework and its supporting infrastructure and professional talent pool needed to create an attractive environment for market participants. There are currently no known markets in all its three core segments which are the Islamic equity and *Sukuk* markets and Islamic fund management. There has also been no known designated Islamic capital market business and transaction in mainland Kazakhstan despite the broader manifestation of relevant legal and regulatory infrastructure governing Islamic banking, *Sukuk*, Islamic investment funds, Islamic insurance (*takafu*) and Islamic leasing.

6.2.2 LEGAL PROVISIONS ON ISLAMIC CAPITAL MARKET OPERATIONS IMPEDES MARKET DEVELOPMENT EFFORTS

The existing legal provisions for Islamic capital market such as Islamic securities contains operational provisions which do not grant flexibility in promoting market development efforts including allowing marketplace innovation. Any subsequent variation to such provisions will require extensive due process which may hamper efficiency and development initiatives. It is therefore vital for the enabling legal provisions to remain but to move all operational matters as subsidiary legislation or product regulation. Such a legal approach will provide legal flexibility and at the same time able to accommodate market development initiatives more efficiently.

6.2.3 TAXATION FRAMEWORK TO FACILITATE ISLAMIC CAPITAL MARKET TRANSACTION REMAIN UNTESTED

According to the NBK, the national taxation framework has been amended to create a level playing field to accommodate Islamic finance vis-à-vis conventional players in terms of tax neutrality i.e. at the application of the pro-rata method of VAT offset for the customers of Islamic banks. Likewise, changes have been made to the Tax Code with a view to facilitate Islamic capital market business and transactions, for example issuance of *Sukuk*. Its operational effectiveness however has yet to be tested and verified in the absence of any Islamic capital market business and transaction applying the relevant Islamic contracts.

6.2.4 SLOW SAVINGS MOBILIZATION AFFECTS DEMAND AND SOLE PENSION FUND FOR ISLAMIC INVESTMENT IS RESTRICTIVE

From a demand perspective, the Unified Accumulated Pension Fund (“UAPF”) under the management and supervision of the NBK has provisions for Islamic investments but it is currently capped at 10% of the fund size with no designated Islamic investments. Meanwhile, the pooling of savings institutions such as Islamic investment funds and asset management and Islamic insurance business remain non-existent in Kazakhstan.

6.2.5 ABSENCE OF ISLAMIC CAPITAL MARKET INSTRUMENTS POSES LIQUIDITY MANAGEMENT CHALLENGES TO ISLAMIC BANKS

Meanwhile, liquidity risk management for Islamic banks in Kazakhstan relies to a large extent on liquidity support from its shareholder/parent institutions owing to the absence of Islamic capital market products, for example *Sukuk* and asset-backed securitization.

6.2.6 NO BENCHMARK SUKUK ISSUANCE TO SPUR SUPPLY OF CORPORATE SUKUK ISSUERS

In terms of benchmarking, there have been no issuance of a sovereign *Sukuk* either in local or foreign currency denomination. Corporate *Sukuk* issuance is also non-existent, hence the absence of a corporate *Sukuk* market. While KaSE on its part has created a separate sectorial designation "Islamic securities" to accommodate the listing of Islamic securities and products, there are no known listing of Islamic products on KaSE to date.

6.2.7 ABSENCE OF ISLAMIC SCREENING FOR LISTED JOINT STOCK COMPANIES (JSCS) AND ISSUANCE OF CORPORATE SUKUK NEGATIVELY AFFECTS ISLAMIC INVESTMENT MANAGEMENT INDUSTRY

Moreover, the equity market in mainland Kazakhstan have no Islamic products, for example Islamic indices or designation of Shari'ah compliant shares due to the non-availability of Shari'ah screening of its listed JSC. Similarly, there is no *Sukuk* market, either corporate or sovereign *Sukuk*. As a consequence, there is an absence of liquid Islamic financial instruments in the capital market. This creates an impediment for the development of an Islamic investment fund and asset management industry, which is currently non-existent.

6.2.8 DIVERSIFICATION IN ASSET ALLOCATION IS LIMITED AS ISLAMIC ALTERNATIVE ASSET CLASSES REMAIN UNDERDEVELOPED

Alternative investment asset classes such venture capital (VC) and private equity (PE) are evidently underdeveloped and is a segment where Islamic VC and PE could potentially tap. Similarly, in the absence of an appropriate frameworks, alternative platforms such as crowdfunding is non-existent and is a space where Islamic equity crowdfunding and Islamic P2P financing could play a meaningful role in supporting the development of an inclusive financial system.

6.2.9 THE TALENT POOL AND EXPERTISE IN ISLAMIC CAPITAL MARKET IS NEGLIGIBLE AT BOTH REGULATORY AND INDUSTRY LEVELS

Since an Islamic capital market is non-existent in Kazakhstan, there is nearly negligible presence of Islamic capital market professionals, experts and scholars other than those in the Islamic banking and leasing business. Al-Hilal Bank is currently a member of KaSE but only acts as an intermediary in the currency market. The supply of talent into the market from higher learning institutions are at an early stage and are in the process of collaborating with external higher learning institutions to introduce Islamic finance programme.

6.3 RECOMMENDATIONS

For Kazakhstan to power its future economy and foster the private sector as the main engine of national growth, the role of markets will be increasingly important in mobilizing private capital. Building the foundation for an advanced Islamic capital market will therefore broaden the avenues for capital formation and investment and deepen the financial market to support development of the real economy.

The prevailing conditions will require Kazakhstan to build and strengthen its Islamic finance ecosystem to support the development of a viable and competitive Islamic capital market. With the core segments of Islamic finance being mutually reinforcing, strengthening the Islamic capital market will draw the synergistic effect of creating a credible and competitive Islamic finance market. Equally significant is to establish a distinct Islamic capital market ecosystem capability and create the condition for its orderly development and growth. Strengthening the foundation for the Islamic capital market and integrating the application of its sound Islamic principles is therefore vital to support development of the real economy and more importantly support global agenda on sustainable development and practices on SRI. In this respect, Islamic capital market development within this Master Plan is designed to chart a comprehensive roadmap for the orderly growth and diversification of Kazakhstan's capital market.

The Islamic capital market plan cuts across its three core segments of Islamic equity, *Sukuk* and Islamic fund management, and is underpinned by 5 strategic pillars namely in the aspects of capital formation, regulation, intermediation, institution and infrastructure. These strategic pillars form the foundation for building and strengthening the Islamic capital market in mainland Kazakhstan.

Premised on the strategic pillars and leveraging on its current strength and identified growth opportunities, 7 core strategic initiatives and the ensuing recommendations will seek to drive and deliver a competitive and advanced Islamic capital market for mainland Kazakhstan. The strategic initiatives and recommendations are as follows:

Strategic Initiatives	Recommendations
<p>1. Promote development of a viable market for capital formation and effective mobilization of Islamic capital.</p>	<ul style="list-style-type: none"> i. Establish a formal organizational structure for Islamic market development; ii. Develop a holistic local currency corporate <i>Sukuk</i> and asset-backed <i>Sukuk</i> securitization markets; iii. Foster Islamic listing of JSC on the stock exchange and promote the Shari'ah screening of listed JSCs; iv. Construction of Islamic indices as infrastructure for Islamic funds industry development; v. Promote monetization of Islamic assets and listing of the alternative assets; vi. Participation of, SOEs, sovereign wealth funds and multilateral institutions in Islamic financing, fund-raising and investments; and vii. Islamic banks to act as catalyst for corporate <i>Sukuk</i> issuance to meet its capital requirements and green/SDG funding objectives.
<p>2. Facilitate offering of a diverse and competitive range of Islamic products and services.</p>	<ul style="list-style-type: none"> i. Strengthen current approach to regulation by making existing operational Islamic capital market legal provisions as product regulation to facilitate market development efforts; ii. Advocate presence of domestic and international service providers offering Islamic screening on Islamic equity; iii. Promote development of product regulation for issuance of <i>Sukuk</i>; iv. Facilitate development of framework for Islamic mutual fund products and Islamic investment services; v. Facilitate establishment of Islamic window for brokers/dealers to trade Islamic securities;

	<ul style="list-style-type: none"> vi. Boost linkages and connectivity with other jurisdictions for cross-border access of Islamic products; and vii. Drive simulation of Islamic business and transaction via stakeholder network to ensure effectiveness of tax neutrality measures.
<p>3. Facilitate robust development of innovative frameworks for a competitive and dynamic financial landscape.</p>	<ul style="list-style-type: none"> i. Apply risk-based principles of proportionality to enhance efficiency and promote market-based innovation; ii. Integrate the application of regulatory technology (“RegTech”) to facilitate the delivery of regulatory requirements more efficiently and effectively; iii. Expand Islamic frameworks for development and listing of alternative asset classes; iv. Foster Islamic strategy and frameworks for green finance and investments; v. Facilitate development of crowdfunding frameworks to promote financial inclusion; vi. Advocate integration of international best practices and principles on Islamic sustainable finance and investments; vii. Promote digital frameworks development to facilitate integration of FinTech into Islamic capital market; viii. Promote integration of Islamic social finance with the Islamic capital market; ix. Strengthen domestic financial architecture and supervisory and regulatory capability through institutional reform measures; x. Integrate domestic accounting standards on Islamic finance with IFRS to promote cross-border recognition and transaction; and xi. Advocate an industry-driven model on Shari’ah governance and the adoption of AAOIFI Shari’ah standards.
<p>4. Strengthen competitiveness and efficiency of market institutions.</p>	<ul style="list-style-type: none"> i. Foster partnership between AIX and external service providers for the development of Islamic products and services; and

<p>5. Broaden Islamic intermediary capability and strengthen competitive environment for Islamic services.</p>	<ul style="list-style-type: none"> i. Enhance the outsourcing of Islamic mandates of state-owned investment and pension funds to external and privately-management funds with a view to scale-up the fund management industry, promote competition and boost market liquidity; ii. Introduce financial incentives and facilitate licensing and registration of alternative asset managers; and
<p>6. Build domestic capacity with linkages across institutions.</p>	<ul style="list-style-type: none"> i. Establish dedicated training institution and develop appropriate time-based strategy on training and accreditation; and ii. Promote linkages between domestic higher learning institutions, industry bodies and regulatory authorities.
<p>7. Expand scale of Islamic markets to boost domestic and regional competitiveness.</p>	<ul style="list-style-type: none"> i. Establish bilateral linkages via mutual recognition agreement with other external jurisdictions and markets; ii. Establish regional cooperation for passporting of Islamic products to gain access into new markets; iii. Enhance bilateral and multilateral memorandum of understanding (MOUs) and linkages for information sharing and supervisory cooperation among recognized jurisdictions to facilitate cross-border financial transactions; and iv. Advocate awareness of Islamic capital market and value proposition of Islamic finance to domestic population and other stakeholders.

6.3.1 STRATEGIC INITIATIVE 1

PROMOTE DEVELOPMENT OF A VIABLE MARKET FOR CAPITAL FORMATION AND EFFECTIVE MOBILIZATION OF ISLAMIC CAPITAL

(i) Establishing a formal organizational structure for Islamic market development

The setting-up of a department focusing on Islamic capital market policy operations and development within a regulator will support orderly development and growth of the domestic Islamic capital market specifically in Kazakhstan. Its function will focus on establishing regulatory frameworks and guidance for issuance of Islamic products and services. The department will have in place internal systems, processes and procedures in dealings with Islamic capital market proposals within a stipulated turnaround time. It will also work with internal and external stakeholders to support developmental Islamic capital market initiatives including formulation and development of strategic initiatives.

(ii) Developing holistic local currency corporate *Sukuk* and asset backed *Sukuk* securitization markets

As series of benchmark local currency *Sukuk* issuances by the government³³ and its agencies will help to price corporate *Sukuk* issuance. Given the right conditions, we should expect corporations, medium size enterprises and beyond to tap the domestic liquidity for example pension fund, fund management, insurance funds and banks. This will promote financial inclusion as market liquidity find its way to finance Shari'ah compliant medium size enterprises and beyond to grow and expand. A retail-based *Sukuk* as well as sustainability-themed *Sukuk*, backed by appropriate regulation, could create new potential for the domestic *Sukuk* market and attract wider investor participation.

(iii) Foster listing of Islamic JSCs on the stock exchange and promote the Shari'ah screening of listed JSCs

Shari'ah compliant listing can be a value proposition for companies who wish to list their shares on the stock exchange as it could potentially attract a wider investor base and potentially attract better pricing for its securities. Similarly, designated Shari'ah compliant securities post-listing will lead to greater secondary market liquidity and facilitate future fun- raising at competitive pricing. Continued efforts with joint coordination with the participants ought to be held at regular intervals to identify and remove any obstacles to issuance processes.

(iv) Introducing Islamic indices as a rating infrastructure for Islamic funds industry development

The development of Shari'ah compliant indices will help grow the Islamic fund management industry and promote financial inclusion by giving access to a diverse set of investment opportunities to investors. Long-term investment institutions such as pension funds, *takaful* and insurance companies will benefit as they can match their business asset-liability profiles to meet their commercial objectives.

(v) Promote monetization of Islamic assets and listing of the alternative assets

Companies with Shari'ah compliant assets will have the opportunity to unlock its true value through monetizing and listing of their assets while at the same time able to retain control over its ownership. SOEs that owned such assets could be the catalyst to attract foreign portfolio investors into investing in the monetised assets with its stable stream of income. Additional incentives such as tax incentives for issuers and investors could be formulated for limited period to bolster the appeal of issuances.

(vi) Participation of SOEs, sovereign wealth funds and multilateral institutions in Islamic financing, fund-raising and investments

SOEs can become the stimulus for growth of Islamic finance. It can do so by using Islamic finance instruments in the course of its business operations. One such aspect is the financing of its expansion. This include issuing corporate *Sukuk*, listing their shares on the stock exchange designated as Shari'ah compliant and other types of Shari'ah compliant corporate exercises. Such initiatives will help create benchmarks and spur growth in Islamic finance business and transactions.

Equally important for the Islamic capital market and to create an ever-ready pool within the market is to remove or loosen the existing limits on institutional investors such as the Unified Accumulative Pension Fund's limit on Islamic investments. The government should establish a National Investment Fund to create a seeding and redistribution mechanism for SOEs or even corporate IPOs to domestic retail investors. A benchmark for Kazakhstan would be the Permodalan Nasional Berhad (PNB) of Malaysia which holds IPO shares in various mutual fund structures and offer them to the general public. This initiative increases the awareness and investing culture of the general population thereby uplifting the available pool of funds available.

³³ May be issued and listed on the AIX.

The idea of a multilateral pool of institutional investors should not be disregarded and a feasibility study should be undertaken for the possible establishment of additional private pension funds or even a national *Haji* Pilgrimage Fund.

(vii) Islamic banks to act as catalyst for corporate *Sukuk* issuance to meet its capital requirements and green/SDG funding objectives

The 3 broad segments of Islamic finance namely Islamic banking, capital market and *takaful* are interdependent and they mutually reinforce one another. In strengthening their capital base, Islamic banks can tap the *Sukuk* market to meet their Tier 1 and Tier 2 capital requirements. Similarly, as they practice sustainable banking, it may consider issuing green *Sukuk* to fund their green financing activities. Likewise, *takaful* companies through its *takaful* funds can invest in long-term *Sukuk* that matches its liabilities.

6.3.2 STRATEGIC INITIATIVE 2 FACILITATE THE OFFERING OF A DIVERSE AND COMPETITIVE RANGE OF CORE ISLAMIC PRODUCTS AND SERVICES

(i) Strengthen current approach to regulation by making existing operational ICM legal provisions as product regulations to facilitate market development efforts

The current approach in legislating operational aspects of Islamic finance and capital market as laws stifled market development efforts. In its current form, the Islamic capital market product regulation are rigid and inflexible. Development of detailed frameworks in the form of product guidelines will provide greater flexibility to encourage and facilitate the supply of Islamic products and services. It will also promote product innovation, allow for introduction of incentives and enhance regulatory efficiency.

(ii) Advocate presence of domestic and international service providers offering Islamic screening on Islamic equity

The presence of ancillary service providers to provide screening of listed JSC shares as designated Shari'ah compliant securities will help construct Islamic indices which in turn assist in the development of the domestic Islamic fund management industry. The service providers could potentially offer diverse screening rules that meet the needs of a broad range of investors, both domestic and foreign.

(iii) Promote development of product regulation for issuance of *Sukuk*

A detailed *Sukuk* framework in the form of *Sukuk* regulations and guidelines will provide guidance to potential issuers and arrangers of *Sukuk*. Clarity in the application of Islamic principles within the framework will drive efficiency, innovation and mitigate Shari'ah non-compliance risks. Certain incentives such as limited exemptions from regulatory compliance could be achieved without the necessity to change legislation which otherwise could be tedious and cumbersome. Regulatory and process efficiency can be enhanced through the imposition of a disclosure-based regulation for the approval and authorisation of securities offering. The regulatory flexibility and efficiency of such framework will help build pipelines of *Sukuk* issuances having varied and diverse profiles and facilitate capital formation.

(iv) Facilitate development of framework for Islamic mutual fund products and Islamic investment services

The development of a product framework for Islamic mutual funds will act as the building block for the supply and offering of a diverse range of investment products. The availability of such investment products will help mobilise savings, promote financial inclusion and ultimately spur development of Islamic wealth management. The framework for Islamic fund management will also accord adequate provision for investor protection imposing governance standards and relevant fiduciary duties on key intermediaries.

Facilitating the presence of foreign and international fund management companies through a competitive licensing regime will (i) help strengthen domestic capability within the Islamic fund industry; (ii) it will bring capable international talent and allow for the transfer of skills and knowhow; and (iii) they will also help to mobilise domestic savings and attract external liquidity and build pipelines of new products for the domestic and regional markets.

(v) Facilitate establishment of Islamic windows for brokers/dealers to trade Islamic securities

The establishment by brokerage firms of Islamic windows for investors to trade in Islamic securities will strengthen the market infrastructure for Islamic investing. It will provide a process for end-to-end solution for Islamic investments. Such propositions could potentially attract regional Shari'ah investors to participate and invest in Kazakhstan's securities market.

(vi) Boost linkages and connectivity with other jurisdictions for cross-border access of Islamic products

Establishing linkages at the regulatory level is vital to build international distribution networks and scale-up the domestic Islamic capital market business and transaction. Specifically, Kazakhstan's Islamic fund management industry will benefit from the opening of markets in regional jurisdictions. With scale, Kazakhstan's domestic fund management intermediaries will become more competitive with clear benefits to investors.

(vii) Drive simulation of Islamic business and transaction via stakeholder network to ensure effectiveness of tax neutrality measures

The current state provisions for tax treatment on Islamic securities in the absence of real transactions should go through a simulation process to examine its effectiveness. This will facilitate addressing operational challenges and remove impediments. Creating a level playing field in the Islamic capital market is critically important to ensure the viability and competitiveness of Islamic finance and the Islamic capital market.

6.3.3 STRATEGIC INITIATIVE 3

FACILITATE ROBUST DEVELOPMENT OF INNOVATIVE FRAMEWORKS FOR A COMPETITIVE AND DYNAMIC FINANCIAL LANDSCAPE

(i) Apply risk-based principles of proportionality to enhance efficiency and promote market-based innovation

The application of proportionality in regulation will help drive industry growth and innovation. It will also promote financial inclusion, sustainable finance and sustainable investments. The application of such principles, however, should be carried out in segments of the market that experience greater level of disruption and potentially transformational. These include areas with rapid integration of technology such as FinTech, Islamic social finance and the digital assets and investments space. Applying proportionality to existing frameworks and regulations should not, however, be done at the expense of protecting investors and preserving market integrity.

(ii) Integrate RegTech to facilitate the delivery of regulatory requirements more efficiently and effectively

Numerous regulatory compliances have resulted in increased friction costs e.g. arising from the need to ensure compliance and for periodical reporting. The consequence is driving away focus from improving performance of the core business. RegTech services provided by FinTech firms to financial intermediaries help to automate internal systems to meet their compliance needs and reporting requirements to supervisory authorities. The liberalisation of such functions to external RegTech providers will enhance regulatory efficiency and enable regulatory supervisors to manage systemic risks more effectively.

(iii) Expand Islamic frameworks for development and listing of alternative asset classes

A diverse and broad investment horizon offering diverse risk-return profiles creates more opportunities for investors. Apart from the traditional investment asset classes, alternative investment strategies are gaining attention and traction even from the likes of pension funds. The increased demand for such alternative investment products require domestic financial authorities to consider expanding existing or introduce new frameworks to accommodate this new investment asset classes. While features of the underlying assets may have liquidity and volatility challenges, the approach to regulation may vary and be restricted to institutional and sophisticated investors.

(iv) Foster Islamic strategy and frameworks for green finance and investments

Kazakhstan is a signatory to the Paris Agreement and its nationally determined contribution target is to reduce greenhouse gas emissions (GHG) by between 15 and 25% by 2030 compared with 1990 levels. It is expected that the share of renewable energy of Kazakhstan including hydro would represent half of the electricity generation mix, the other half being attributed to gas-fired power plants. There is growing evidence of the role of markets to mobilise funds to finance climate mitigation and adaption projects especially in large scale renewable energy. Development of green bond and *Sukuk* frameworks together with appropriate incentives will help spur development of the domestic bond market as the annual growth in green financing increases exponentially globally.

(v) Facilitate development of crowdfunding frameworks to promote financial inclusion

There are sectors within the economy which do not have the coverage of formal financial institutions such as banks. However, the advent of digital finance and FinTech have allowed for innovative funding models to emerge. Digital-based crowdfunding is one of the effective means to raise funds for small businesses and start-ups. Development of a fit-for-purpose regulatory framework for crowdfunding to facilitate P2P lending and equity crowdfunding will pave the way for service providers to set-up appropriate platforms to facilitate capital formation and promote for an inclusive financial system.

(vi) Advocate integration of international best practices and principles on Islamic sustainable finance and investments

Integrating internationally recognised International Islamic Capital Market Association's (ICMA) green and social bond principles and the United Nation Principle For Responsible Investment into domestic regulatory frameworks or be treated as industry best practices will help build investors and market confidence. Likewise, it will drive growth in the SRI market. Embracing such principles will help increase transparency and integrity of markets and strengthen the capability of various stakeholders across the SRI value chain including its core and ancillary service providers.

(vii) Promote digital frameworks development to facilitate integration of FinTech into Islamic capital market

The increasing role of FinTech to drive greater efficiency and scale is transformational. The establishment of regulatory sandboxes and independent, innovative FinTech platforms have enabled development of appropriate regulatory frameworks to regulate financial services by FinTech. This will foster growth of FinTech services as alternative to the traditional financial services. The application of blockchain technology for example has not only enhanced levels of transparency but help build system integrity, drive scale and efficiency into the marketplace. These sandboxes' effectiveness can be ramped up if the cross-application of their services can be tested and verified by partners within another sandbox. While traditionally, most developers work in silos, they would benefit immensely from the cross-collaboration between regulatory sandboxes and the ability of working within a harmonize framework.

(viii) Promote integration of Islamic social finance with the Islamic capital market

Zakat and *waqf* are important Islamic social finance initiatives as redistribution mechanism but they have traditionally been plagued with issues of confidence and trust. Poor governance and low levels of transparency further complicate their development. Leveraging on the Islamic capital market frameworks and capabilities of its licensed intermediaries, mobilising *waqf* and *zakat* will potentially drive greater scale and promote development of social enterprises and socially responsible initiatives for the advantage of beneficiaries.

(ix) Strengthen domestic financial architecture and supervisory and regulatory capability through institutional reform measures

Institutional reform measures with a view to strengthening regulatory and supervisory capabilities are not new. They are designed to address current structural weaknesses in financial supervision that have led to the recent global financial crises. The adoption of a 'twin peak' model of separating the overseeing of financial conduct and prudential regulation, as is being proposed for Kazakhstan now, is designed to make them into more effective pair of bodies. Under the model, the financial conduct authority will be responsible for ensuring that relevant markets function well and is the supervisor for its regulated entities. Its primary operational objectives are consumer protection, preserving market integrity and effective competition. The prudential regulator meanwhile will be responsible for promoting the safety and soundness of banks and insurers and systemically important firms and is the prudential supervisor of these licensed firms. These firms are traditionally dual regulated by the financial conduct authority for conduct and prudential regulatory authority for prudential issues.

(x) Integrate domestic accounting standards on Islamic finance with IFRS to promote cross-border recognition and transactions

Accounting treatment of Islamic financial transactions based on international financial reporting standards will allow Islamic finance integration and facilitate its further development and growth. The very fact that the IFRS has recognised the specificities of Islamic transactions and to treat them accordingly will contribute towards greater recognition of Islamic finance globally and able to attract and promote cross border investments. Integration of a digital regulatory interface will enhance transparency and consistency of process, in turn enhancing the appeal of inflow trade.

(xi) Advocate an industry-driven model on Shari'ah governance and the adoption of international standards such as the AAOIFI Shari'ah and Governance standards

A market-driven model for Shari'ah governance is one of the prevalent models for Islamic finance. It is imperative for a market player to benchmark their practices against international Shari'ah standards especially the AAOIFI Shari'ah and Governance standards so as to gain international recognition as well as promote standardisation of Shari'ah practices globally.

6.3.4 STRATEGIC INITIATIVE 4

STRENGTHEN COMPETITIVENESS AND EFFICIENCY OF MARKET INSTITUTIONS

- (i) **Foster partnership between AIX, KaSE and external service providers for the development of Islamic products and services**

The creation of an Islamic universe of investments will allow for other infrastructure-related Islamic products to be developed. The development and launch of Islamic indices by those stock exchange through collaboration with external providers could be used as benchmarks for the construction of investment strategies and products by fund and asset management service providers. These initiatives can lead to Shari'ah screening of JSC stocks and promote the investment from retail and institutional investors into Shari'ah compliant stocks as a new asset class, along with increasing awareness among key stakeholders to deepen the capital market. The exchanges can further deepen the capital market and attract greater liquidity by promoting commonalities between Islamic investing and sustainable investing as an SRI asset class within a dedicated platform which can be introduced in tandem for listing of domestic and foreign *Sukuk*.

6.3.5 STRATEGIC INITIATIVE 5

BROADEN ISLAMIC INTERMEDIARY CAPABILITY AND STRENGTHEN COMPETITIVE ENVIRONMENT FOR ISLAMIC SERVICES

- (i) **Enhance the outsourcing of Islamic mandates of state-owned investment and pension funds to external and privately-management funds with a view to scale-up the fund management industry, promote competition and boost market liquidity**

The delegation of investment mandates by pension and national funds to external private fund managers will strengthen their fund management capability and performance track record. This in turn will attract participation of new investors, both institutional and retail, into its funds and allow the fund managers to scale-up their asset under management (AUM) portfolios. A performance track record, will facilitate opportunities of marketing and distribution of its products into regional markets. Likewise, the lifting of restrictions and limits imposed on Islamic investments for example on the state pension funds will potentially help attract greater participation by Islamic funds and asset managers thus creating a level playing field within the investment management industry. The pension and national funds can then monitor the private fund managers' performance as signals of growth and expansion while alleviating their own restrictions in terms of finding avenues of investment.

- (ii) **Introduce financial incentives and facilitate licensing and registration of alternative asset managers**

Broadening the investment horizon within the financial investment landscape will provide opportunities for investors to diversify their investments. It is thus imperative to promote and attract the participation from a diverse range of players offering diverse investment strategies. Efforts should also be done to offer appropriate financial incentives to help grow an industry that is still very much at its infancy. Alternative investments such as Islamic REIT managers, Digital Asset Managers and others, is one such potential. It requires specialized capabilities and the appropriate licensing framework. A distinct licensing regime, regulatory and supervisory approach may be required to cater to these diverse options. As the nature of the alternative investments are generally riskier, restriction on the types of investors may be necessary. Newer models within the global trend also integrate more and more the *waqf* model into the Islamic capital market as the focus of investing has diversified and broadened to include agendas such as financial inclusion and sustainability.

6.3.6 STRATEGIC INITIATIVE 6

BUILD DOMESTIC CAPACITY WITH LINKAGES ACROSS INSTITUTIONS

- (i) Establish dedicated training institution and develop appropriate time-based strategy on training and accreditation³⁴.

Talent development is essential if the Islamic finance industry is to grow. The availability of a structured Islamic finance education and training programme complemented with recognized accreditation are crucial to ensure a stable supply of talent that matches the needs of the industry. In this regard, collaboration and coordination between the government, academia and industry as the key stakeholders are vital to ensuring orderly development of Kazakhstan's Islamic finance industry.

- (ii) Promote linkages between domestic higher learning institutions, industry bodies and regulatory authorities

The development of Islamic finance modules for capacity building must entail the input and participation from the Islamic financial services industry. This is to ensure that the Islamic finance talent coming into the market are relevant and able to accommodate the rapid and dynamic changes of the marketplace. These linkages between the Islamic financial institutions and professionals would also facilitate the cross-advisory services and transfers of knowledge between domestic participants. Expansion of these linkages to institutions abroad will provide even greater exposure and transfer of knowledge. In terms of industrial exposure between markets, such linkages can give a chance for attachment opportunities between the three supporting infrastructure of academia, regulators and business institutions.

6.3.7 STRATEGIC INITIATIVE 7

EXPAND SCALE OF ISLAMIC MARKETS TO BOOST DOMESTIC AND REGIONAL COMPETITIVENESS

- (i) Establish bilateral linkages via mutual recognition agreement with other external jurisdictions and markets

Expanding regulatory linkages and connectivity will pave the way for domestic Islamic financial products to secure access into new markets. Through such linkages, domestic financial service providers will have the opportunity to build its regional and international distribution network for distribution without the need to obtain the foreign host jurisdiction's prior authorization. In this regard, the ARDFM, NBK, AFSA, AIX and KaSE should identify appropriate jurisdictions with market potential and establish mutual recognition arrangements. This will help its financial intermediaries, such as fund managers, to build scale and become internationally competitive.

- (ii) Establish regional cooperation for passporting of Islamic products to gain access into new markets

Kazakhstan's participation in any existing regional passporting regime, such as passporting of funds including Islamic funds, will facilitate mutual access of products into such regional markets. Participating in such passporting regime will allow for the presence of foreign investment products in domestic market, increasing the supply within a shorter timeframe. In reciprocal, such participation also allows Kazakhstan's domestic financial intermediaries to gain access into the platform's regional markets. In this regard, Kazakhstan should examine its current position and policies on liberalization of domestic financial markets and state of readiness to open-up its domestic market to foreign products.

- (iii) Enhance bilateral and multilateral MOUs and linkages for information sharing and supervisory cooperation among recognized jurisdictions to facilitate cross-border financial transactions

³⁴ Accreditation emphasizes on quality and international recognition.

Bilateral arrangements entered into between Kazakhstan and other jurisdictions will establish regulatory cooperation that can pave the way for service providers to market and distribute financial products, such as Islamic funds, into each other's financial markets. The arrangement provides greater level of comfort to the respective regulatory and supervisory authority with regard to investor protection and compliance on anti-money laundering and counter terrorism financing measures. With such arrangements in place, fund managers operating in both jurisdictions will experience a more seamless process and bear minimalized friction costs than it would otherwise have to.

(iv) Advocate awareness of Islamic capital market and value propositions of Islamic finance to domestic population and other stakeholders

Enhancing the level of awareness about Islamic finance and more specifically its Islamic capital market operations, products and services to the general public and population and other key stakeholders is a function of demand. Branding and profiling initiatives of the industry are a significant component of the ecosystem. Constant efforts by regulators and the industry to showcase the value propositions of the Islamic capital market and Islamic finance will broaden the avenues for financial inclusion. Likewise, Islamic finance's core principles of upholding and promoting social justice, equity and fairness are consistent with the current global movement on sustainable and responsible finance and can broaden demand for Islamic financial products and services.

6.4 ACTION PLANS

The development of an Islamic capital market will add to the breadth and diversity of the overall Kazakhstan capital market as well as provide a significant contribution the overall growth of the financial services industry.

A comprehensive, multi-pronged approach is needed to develop an Islamic capital market and enhance its competitive position. To this end, detailed action plans and work programmes have been identified that will need to be undertaken to achieve the intended strategic objectives, as follows:

**6.4.1 STRATEGIC INITIATIVE 1
PROMOTE DEVELOPMENT OF A VIABLE MARKET FOR CAPITAL FORMATION AND EFFECTIVE MOBILIZATION OF ISLAMIC CAPITAL**

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider the issuance of series of government <i>Sukuk</i> in local currency with varying maturities as pricing benchmarks and yield curves to facilitate corporate <i>Sukuk</i> issuances.						AIFC Authority, Ministry of Finance
2.	Suggest to formulate tax incentives for issuers and investors of <i>Sukuk</i> .						AIFC Authority, Ministry of Economy, Ministry of Finance
3.	Suggest to reduce existing limit on Islamic investments by the UAPF.						AIFC Authority, NBK
4.	Suggest that Islamic banks consider capitalization through the issuance of						AIFC Authority, Islamic banks

	<i>Sukuk</i> to meet its capital requirements.						
5.	Suggest that SOEs utilize Islamic financing through the issuance of <i>Sukuk</i> to finance its expansion and diversification.						AIFC Authority, Samruk Kazyna, Baiterek
6.	Suggest to consider the issuance by Islamic banks of green <i>Sukuk</i> for green lending portfolio.						Islamic banks, AIFC Authority
7.	Promote Islamic mortgage securitization of Islamic banks mortgage assets by mortgage corporations / institutions.						AIFC Authority, Mortgage corporations / institutions
8.	Suggest that SOEs monetize their income-generating Shari'ah compliant assets by listing as Islamic REITs.						AIFC Authority, Samruk Kazyna, Baiterek
9.	Suggest to undertake feasibility study to consider establishing additional pension funds for the private sector and Hajj Pilgrimage Funds.						AIFC Authority, NBK, ARDFM

6.4.2 STRATEGIC INITIATIVE 2 FACILITATE THE OFFERING OF A DIVERSE AND COMPETITIVE RANGE OF CORE ISLAMIC PRODUCTS AND SERVICES

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to introduce domestic and international service providers offering Islamic screening on Islamic equity.						AIFC Authority, AFSA
2.	Suggest to consider the provision of financial taxation incentives to issuers of Islamic securities and investors to promote industry growth for example Islamic funds and <i>Sukuk</i> ³⁵ .						AIFC Authority, ARDFM, Ministry of Economy, Ministry of Finance
3.	Suggest to formulate Shari'ah governance, disclosures and compliance						AIFC Authority, AFSA

³⁵Taxation incentives are targeted towards growth of the domestic corporate *Sukuk* market, in particular issuance, investors, Islamic fund managements – tax incentives for fund managers.

	frameworks for Islamic funds and Islamic fund management to facilitate the launch of Islamic fund and management of Islamic funds ³⁶ .						
4.	Promote establishment of Islamic window for broker/dealer to facilitate trading of Islamic securities.						AIFC Authority, AFSA
5.	Suggest to consider establishing linkages at the regulatory level with other jurisdictions for cross-border access of Islamic products.						AIFC Authority, AIX, AFSA

6.4.3 STRATEGIC INITIATIVE 3 FACILITATE ROBUST DEVELOPMENT OF REGULATORY FRAMEWORK FOR INNOVATIVE AND DYNAMIC LANDSCAPE

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to develop product regulation for Islamic alternative assets including Islamic REITs, commodity-based Islamic ETF, Islamic PE.						AIFC Authority, ARDFM, AFSA
2.	Suggest to formulate SRI frameworks for issuance of corporate SRI <i>Sukuk</i> and launch of Islamic SRI funds.						AIFC Authority, AFSA
3.	Suggest to establish frameworks to facilitate Crowdfunding and a crowdfunding platform for Islamic Equity and Islamic P2P financing.						AIFC Authority, AFSA
4.	Advocate integration of international best practices ³⁷ and principles on Islamic sustainable finance and investments.						AIFC Authority, AFSA
5.	Suggest to consider establishment of collaboration and linkage between regulatory sandboxes to facilitate						AIFC Authority, AFSA

³⁶ Frameworks for Shari'ah governance, disclosures and compliance.

³⁷ Green Bond and Social Bond Principles

	integration of digital finance and financial technology.						
6.	Suggest to integrate <i>waqf</i> into existing capital market regulation to promote Islamic social finance for example Islamic equity, <i>Sukuk</i> and Islamic funds frameworks.						AIFC Authority, AFSA
7.	Suggest to undertake study and measures to adopt a twin-peak regulatory model for effective supervision and development of financial market including capital market in AIFC.						AIFC Authority, AFSA
8.	Suggest to adopt a market-driven model for Shari'ah governance for Islamic capital market operations anchored against AAOIFI Shari'ah and Governance standards.						AIFC Authority, ARDFM, AFSA

6.4.4 STRATEGIC INITIATIVE 4 STRENGTHEN COMPETITIVENESS AND EFFICIENCY OF MARKET INSTITUTIONS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to facilitate the Shari'ah screening of listed JSC stocks on AIX and promote Islamic investing among retail and institutional investors as a new asset class.						AIFC Authority, AIX
2.	Promote awareness of Islamic investing to the general public and other key stakeholders with a view to deepen the capital market.						AIFC Authority, AIX

6.4.5 STRATEGIC INITIATIVE 5

BROADEN ISLAMIC INTERMEDIARY CAPABILITY AND STRENGTHEN COMPETITIVE ENVIRONMENT FOR ISLAMIC SERVICES

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to enhance the outsourcing of Islamic mandates by pension funds and NBK's treasury to external and privately-management Islamic fund management company.						AIFC Authority, Ministry of Finance, NBK
2.	Suggest to consider licensing and registration of Islamic REITs manager, Islamic VC and Islamic PE and Digital Assets.						AIFC Authority, AFSA

6.4.6 STRATEGIC INITIATIVE 6

BUILD DOMESTIC CAPACITY WITH LINKAGES ACROSS INSTITUTIONS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish a dedicated collaborative Islamic capital market training program and develop appropriate accreditation strategy.						AIFC Authority, NBK, ARDFM, Industry players, Universities
2.	Suggest to strengthen Islamic finance education program through collaboration and building linkages between local universities, industry bodies and regulatory authorities.						AIFC Authority, NBK, ARDFM, Industry players, Universities
3.	Suggest to consider the encouragement of participation of foreign Islamic financial institutions and Islamic finance professionals to advise and facilitate the necessary transfer of knowledge to domestic participants.						AIFC Authority, NBK, ARDFM, AIFC bodies, Industry players
4.	Suggest to accommodate industry attachments of domestic Islamic finance academicians with Islamic finance institutions and regulatory authority.						NBK, ARDFM, AIFC bodies, Industry players

6.4.7 STRATEGIC INITIATIVE 7

EXPAND SCALE OF ISLAMIC MARKETS TO BOOST DOMESTIC AND REGIONAL COMPETITIVENESS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish mutual recognition agreements with external jurisdictions to facilitate the cross-border offering and distribution of Islamic financial products in the host jurisdictions.						AIFC Authority, ARDFM, NBK, AFSA
2.	Suggest that the regulators participate in regional and/or multilateral passporting regime on Islamic funds/collective investment schemes.						AIFC Authority, ARDFM, AFSA
3.	Suggest to establish a promotional and profiling platform for Islamic finance including Islamic capital market to create awareness and literacy ³⁸ .						AIFC Authority, NBK, ARDFM, Industry players

³⁸ The platform can be in various forms but the main objective is to promote the growth and development of the Islamic capital market. For example, to have a dedicated programme on investors' literacy and education.

7.1 INTRODUCTION

Prior to the amendments to the “Law on Insurance and Insurance Activities” was made in 2010 to accommodate *takaful* activities, the first *takaful* operator had been established in the form of a mutual insurance society by the name MIS Akniet, later renamed MIS *Takaful*. Among the *takaful* products offered then by MIS *Takaful* were: (i) voluntary medical insurance of tourists going abroad; (ii) voluntary accident insurance; and (iii) voluntary health insurance. The first product, voluntary medical insurance of tourists going abroad included the following offerings: *hajj* (*takaful* insurance of citizens traveling abroad for the purpose of pilgrimage to holy places (*hajj* and *umrah*)); tourism (includes *takaful* insurance of tourists traveling abroad on a tourist trip or vacation); education (*takaful* insurance for students going abroad for study); work (*takaful* insurance of citizens traveling abroad on a business trip, traveling for employment); and visa (*takaful* insurance of citizens traveling abroad with various other purposes).

As the pioneer *takaful* operator in Kazakhstan, MIS *Takaful* faced, among others, the following challenges:

- (a) due to the lack of appropriate instruments to invest the proceeds of the *takaful* fund, it had to resort to accumulating and saving participant’s contributions. This saw the number of its participants decreasing from 288 in the beginning to only 151 members by 2013; and
- (b) the absence of any legal provision in the “Law on Mutual Insurance” that clearly allows MIS *Takaful* to operate as a *takaful* operator. Although at the start the NBK did not require MIS *Takaful* to obtain licence while operating; public confidence remained low due to this legal ambiguity. Further, without clear legal provision, MIS *Takaful* would not be able to access support from re-*takaful* companies.

Eventually, MIS *Takaful* was forced to cease operation; and as a result, Kazakhstan does not have a single *takaful* operator at the moment. Without any *takaful* operator, it is impossible for there to be any demand for re-*takaful* operation in Kazakhstan.

AIFC adopted AIFC Takaful and Retakaful Prudential Rules. A Takaful Operator licensed to operate in the AIFC can adopt any Takaful model to operate its Takaful business to provide protection against a wide range of risks to a range of customers, spread across various business segments. The capital requirements for the takaful/retakaful companies at the AIFC is US\$7 million. AFSA has issued a Notice “AFSA-Q-OA-2020-0031 ON MODIFICATION” on 24th September 2020, that sets the Capital Floor: (a) for Incorporated Takaful Operator carrying on General Takaful Business, including AIFC Incorporated Takaful Operator pursuing takaful business in one or more categories referred to Categories of General Takaful 10, 11, 12, 13, 14, 15, 19 and 20; (b) US\$3,000,000 for another AIFC Incorporated Takaful Operator carrying on General Takaful Business; (c) US\$1,500,000 for an AIFC Incorporated Takaful Operator carrying on General Takaful Business who underwrites only a single category referred to Categories of General Takaful 1 and 2 (d) US\$5,000,000 for an AIFC Incorporated Takaful Operator carrying on Family Takaful Business; (e) or amount specified in writing by the AFSA. The notice comes into effect from 1 November 2020 and remains effective until 1 November 2023.

7.2 ISSUES AND CHALLENGES

Since then however, changes have taken place following the Road Map IF2020 via amendments made to the “Law on Insurance and Insurance Activities” in 2015 that enables the creation of *takaful* and re-*takaful* operators to undertake *takaful* and re-*takaful* activities in Kazakhstan.

However, even with the said amendments, gaps and challenges still persist that severely hamper any re-emergence or growth and development of the *takaful* industry.

7.2.1 REGULATORY GAP IN THE DEFINITION OF 'TAKAFUL' AS AN 'ISLAMIC INSURANCE'

The law allowing *takaful*, the "Law on Insurance and Insurance Activities", do not make any reference to the terms "*takaful*" or "*re-takaful*" and uses the terms "Islamic insurance" and "reinsurance" instead. This definition reflects a misunderstanding of the concept of *takaful* within the umbrella framework of Islamic financial system and does not adequately capture the whole essence of *takaful* and *re-takaful*.

Additionally, the law still applies the term 'life insurance' to refer to 'family *takaful*' activities; which is an anomaly as the Shari'ah jurisprudence under *takaful* principles does not permit 'life insurance' which, by its conventional design, includes the element of 'betting' (*maysir*) on one's life expectancy and the purchase of a policy for an uncertain subject matter - a contingency situation. This legal gap may be operationally inhibitive as even if a *takaful* operator can be set up in Kazakhstan, it may not pass the Shari'ah compliance requirements and audit that *takaful* operators are to adhere to due to its operational nature as an insurance company. This legal issue touches upon the fundamental aspects of *takaful* and may have contributed to there being no *takaful* operators in Kazakhstan currently.

7.2.2 SILENCE IN LEGAL FRAMEWORK ON THE RIGHTS OF PARTICIPANTS

Islamic insurance under the law is also rather narrowly defined to refer to mutual protection and cross liability of insurers when in fact, *takaful* laws should refer to the mutual protection and cross liability of the *takaful* participants among themselves, with the *takaful* operator only playing the role of manager on behalf of the *takaful* participants.

The "Law on Insurance and Insurance Activities" appears to be silent on the rights of the *takaful* participants, in particular as to what would happen to the *takaful* fund in the event of misconduct/negligence/breach of trust by the *takaful* operator, or in the case of the insolvency of the *takaful* operator. Consumers have become more aware and concerned with mis-selling and policy-tossing by insurance companies/*takaful* operators, and it would enhance public confidence if these issues are well covered under the said law.

7.2.3 EXISTING ENTRY BARRIERS FOR TAKAFUL OPERATORS AND PRODUCTS

The law on 'Islamic insurance' in Kazakhstan was an incremental development on piece-meal basis which had caused much uncertainty in the market and severely hampered the development of *takaful* in Kazakhstan. While there had been an attempt at introducing *takaful* into Kazakhstan, such an attempt had failed as the law had not been developed in a comprehensive manner. Initially, *takaful* had existed within Kazakhstan in the form of a mutual insurance society.

With the legal amendment in 2015 however, *takaful* or 'Islamic insurance' in Kazakhstan may only be operated only as a full-fledged joint stock company. This legal structure requires a significantly larger capital and represents a more substantial establishment barrier compared to the relatively simpler mutual insurance society model. Additionally, the law also does not permit a conventional insurer to operate a *takaful* 'window'. These restrictions place a burden on any new entrant seeking to 'test the waters' or leverage on existing goodwill.

Our FGDs also reveal that product restrictions also have a negative impact upon Kazakhstan's first foray into the *takaful* industry. *Takaful* products had to be developed for the voluntary insurances covers only, which is a significant market loss as Kazakhstan's insurance market is predominantly focussed on mandatory insurance covers such as vehicular insurances. *Takaful* operators also face with the problem of a lack of appropriate instruments to invest the proceeds of the *takaful* fund, which had caused the operator to resort to accumulating and saving participant's contributions. This is certainly not ideal especially in an ecosystem where there are no *re-takaful* support to access to.

7.3 RECOMMENDATIONS

The recommendations set out below would be facilitated by an Islamic finance department within the regulators who are dedicated to studying the requirements of a *takaful* operation and how to supervise *takaful* windows and full-fledged operations.

Strategic Initiatives	Recommendations
1. Review of existing regulatory framework to address gaps and anomalies.	<ul style="list-style-type: none"> i. To improve the legal framework on national Islamic insurance laws to include the rights of <i>takaful</i> participants in event of breach by operators; and ii. To permit the establishment of <i>takaful</i> windows by conventional insurance providers.
2. Establishment of soft infrastructures necessary for the <i>takaful</i> ecosystem.	<ul style="list-style-type: none"> i. Expand the product diversity on <i>takaful</i> operators and allow <i>takaful</i> operators to offer all types of <i>takaful</i> products; and ii. To integrate the information technology infrastructure in the offering of <i>takaful</i> products.

7.3.1 STRATEGIC INITIATIVE 1 REVIEW OF EXISTING REGULATORY FRAMEWORK TO ADDRESS GAPS AND ANOMALIES

- (i) **Improve the legal framework on national Islamic Insurance laws by including the rights of *takaful* participants in the event of a breach by the operators.**

To create confidence in the *takaful* market of Kazakhstan and by extension the AIFC, it is important that any review of the laws are conducted in a comprehensive manner including entrenching the rights of *takaful* participants. Currently the legal framework for *takaful* in both Kazakhstan and AIFC contain gaps and anomalies and require remedial measures.

Introduction of parallel and reciprocal legislation may be made to ensure that regardless of the location, the rights of *takaful* participants are protected. A reciprocal and parallel regime will provide the market participants and various stakeholders with the confidence that *takaful* operators will not engage in acts of mis-selling or even outright policy-tossing between the two jurisdictions.

- (ii) **Permit the establishment of *takaful* windows by conventional insurance providers**

Similarly with Kazakhstan's banking sector, participation by local industry players into the *takaful* market can be encouraged by allowing the conventional insurers to leverage on existing customer goodwill and at a lower costs by allowing the establishment of *takaful* windows. This is more so as the *takaful* windows can act as a secondary investment channel to pump more liquidity in the market and create a pool of Islamic assets that can be channelled into the Islamic capital market thus creating a knock-on effect to help further develop the Islamic finance in both Kazakhstan and the AIFC. If there are concerns on the supervisory aspects of a *takaful* window in particular in terms of ensuring the separation and Shari'ah governance of operations, the AIFC and the ARDFM may obtain guidance and training from regulators from Malaysia and other jurisdictions who have experience in supervising window operations.

7.3.2 STRATEGIC INITIATIVE 2

ESTABLISHMENT OF SOFT INFRASTRUCTURES NECESSARY FOR THE TAKAFUL ECOSYSTEM

- (i) **Expand the product diversity on *takaful* operators and allow *takaful* operators to offer all types of *takaful* products**

To ensure that the *takaful* operators are able to channel their available funds into proper growth areas and provide an avenue for liquidity management, the AIFC and the ARDFM should consider allowing wide-ranging types of investments and instruments *takaful* operators could invest in. Product development should be left to the market with the regulators playing a more supervisory role. It is recommended that the regulators are empowered to provide guidance on the application of Shari'ah principles, with input from a central Shari'ah body, while supervising and monitoring the best practices of the operators as well as introducing prudential standards to further strengthen the industry.

- (ii) **Integrate the information technology infrastructure in the offering of *takaful* products.**

Intermediaries will find themselves having to adapt to a changing environment with an increasingly pervasive use of technology within both the retail and commercial spheres. Knowledge and technology are the key defining advantage in terms of industry competitiveness and economic growth potential. Our FGDs have revealed that within Kazakhstan's financial sector, the insurance industry is one of the fastest industries in grasping this change. Most insurers are looking towards a more paperless and virtual environment.

As such, the AIFC ought to facilitate this integration of technology in *takaful* and re-*takaful* industry. Both regulators could consider introducing virtual *takaful* licenses where with the help of FinTech integration, the AIFC can be made into a *takaful* hub, offering wireless *takaful* services throughout Kazakhstan and the region.

Working within the relevant technological and information infrastructure, AFSA can facilitate cost-effective and efficient online regulatory oversight utilising a more electronic or virtual platform. Based on the experience of Malaysia which had introduced an internet *takaful* framework since 2004, the linkages via online platform could enable the regulator a more robust oversight mechanism.

7.4 ACTION PLAN

7.4.1 STRATEGIC INITIATIVE 1

REVIEW OF EXISTING REGULATORY FRAMEWORK TO ADDRESS GAPS AND ANOMALIES

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to improve the legal framework on national Islamic insurance laws by including the rights of <i>takaful</i> participants in event of breach by operators.						AIFC Authority ARFDM, AFSA
2.	Suggest to permit the establishment of <i>takaful</i> windows by conventional insurance providers; to enable other legal structures for <i>takaful</i> including the mutual <i>takaful</i> model.						AIFC Authority, ARFDM

7.4.2 STRATEGIC INITIATIVE 2

ESTABLISHMENT OF SOFT INFRASTRUCTURES NECESSARY FOR THE TAKAFUL ECOSYSTEM

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to expand the product diversity for <i>takaful</i> operators and allow <i>takaful</i> operators to offer all types of <i>takaful</i> products.						AIFC Authority, AFSA
2.	Suggest to integrate the information technology infrastructure in the offering of <i>takaful</i> products.						AIFC Authority, AFSA

8.1 INTRODUCTION

Kazakhstan is the world's ninth-largest country by area, and it has made significant changes and progress in scaling up its economy since independence. Strong natural resources support the country, and over three-quarters of its surface area is suitable for farming. Kazakhstan has a wealth of natural resources with some of the world's largest deposit of natural resources like a significant reserve of oil, copper and iron ore. It also has relatively high human capital as measured by the World Economic Forum's Global Human Capital Report 2017³⁹.

One of its economic achievements lie in the development of the financial sector. However, the country encounters major problems in both the supply and demand for financial services which have not been seriously addressed by the government and remain unresolved.

The government of Kazakhstan's national plan lays out a new economic model amid the banking sector facing pressure and even bracing for more mergers and acquisitions or defaults. This situation is due to debt-ridden banks, currency devaluation and NPLs. Kazakhstan's banking system is relatively small and had experienced the severity of external shocks and weak governance.

The banking sector remains a top priority, and the regulator has to undertake strategic policies to strengthen oversight and capital requirement, reduce dollar usage and resolve bad assets to improve the situation and preserve banking sector stability.

Given the current situation of the banking sector, the non-banking sector of this country reflects significant facts. The non-banking sector is expected to provide a route of economic diversification, given the limited size of the domestic demand market. The government could not rely very much on the banking sector. Real financial linkages remain the weakness of the economic structure of Kazakhstan. Key economic sectors which account for almost 40% of the GDP, including the oil and metal sectors, obtain sources of funding from abroad.

The non-banking sector which seems to have programs and direct linkages to the society is expected to build a more balanced economic structure that would strengthen resilience to any economic shocks. The non-banking institutions facilitate financial services and supplement banks by providing infrastructure to allocate surplus resources to individuals' and companies' deficits and to meet the needs of specific clients. This sector also may specialize in a particular sector to enhance competition within the financial services industry. Its existence contributes to the stability of the nation, the economy and the entire financial system. The lack of this sector can lead to a credit bubble and asset overheating. Therefore, regulating this sector is significant to ensure sustainability and continual growth with the proper ecosystem to achieve the desired results.

The non-banking organizations are institutions that provide limited banking services without holding a full banking license and accepting deposits from the public. Such organizations include mortgage, leasing or microfinance organizations and they enhance competition within the financial services industry. These organizations contribute to the stability of the nation, the economy and the entire financial system. An absence of this sector may lead to a credit bubble and asset overheating. Therefore, regulating this sector is essential to ensure sustainability and continual growth with the proper ecosystem to achieve the desired results. The non-banking sector can also play an instrumental role in particular when its financial institutions offer credit financing associated with productivity improvement with efficient allocation of resources with technology transfer and a low rate of financing.

The non-banking sector is expected to provide a route of economic diversification, given the limited size of the domestic demand market and the fact that the government could not rely wholly on the banking sector. Real financial linkages remain the weakness underlying the economic structure of Kazakhstan. Key economic

³⁹ "World Human Capital Report 2017", *World Economic Forum Global*, September 13, 2017. Retrieved from <https://weforum.ent.box.com/s/dari4dktg4jt2g9xo2o5pkspatvawdb>

sectors, particularly the oil and metal sectors which account for almost 40% of GDP, obtain a source of fund from abroad.

The Kazakhstan 2025 strategic development plan focuses on productivity and growth to support the country's long-term aspiration of joining the 30 most developed country by 2050. Therefore, the non-banking sector that seems to have programme and linkages directly to the society is expected to build a more balanced economic structure that would strengthen resilience to any economic shocks.

In AIFC an Islamic non-bank institutions will essentially be required to hold a license for only one regulated activity defined in Schedule 1 of the AIFC GEN rules – Providing Islamic Financing. For example, non-bank institution will be classified as an Islamic Financing Company (IFC) as defined in AIFC IBB rules. The IFC will be treated as an Islamic Financing Company in the AIFC even if it is also authorised to conduct any other activity that is not Islamic Banking Business. The IFC does not cease to be an Islamic Financing Company because it conducts other activities included in its authorisation. The IFC may act as an Islamic Broker Dealer in Shari'ah-compliant investments or assets, if it receives the necessary licenses from the AFSA.

The capital requirements for the Islamic Financing Company at the AIFC is US\$2 million. AFSA has issued a Notice "AFSA-Q-OA-2020-0028 ON MODIFICATION" on 24th September 2020, that sets the base capital requirement: (c) for an Islamic Financing company: (i) in case if only own funds are used – US\$100,000; (ii) in case if not only own funds are used – US\$500,000. The notice comes into effect from 1 November 2020 and remains effective until 1 November 2023.

As of 1st July 2019, the non-banking sector comprised of three mortgage companies (namely, Kazakhstan Mortgage Company JSC ("KMC"), JSC Baspana and JSC Express Finance) and four non-banking institutions (namely, JSC Agrarian Credit Corporation, JSC Agriculture Financial Support Fund, JSC KazAgroFinance and JSC Kazpost ("Kazpost"), (the national mail operator) offering certain types of banking products (NBK, 2019 July)⁴⁰.

The value of total assets of three mortgage companies is KZT573.7 billion, with the loan portfolio constituting 54.7% (KZT314.1 billion) and securities at 34.8% (KZT199.4 billion). The loan portfolio mainly comprises the financial lease and long-term loans (45.6% and 52.1%, respectively). As for the performance of non-banking institutions offering certain types of banking products, the total assets of four organizations amounted to KZT1,058.6 billion, out of which 50.5% is occupied by lending, the financial lease at 19.9% and cash at 12.3%. The combined loan portfolio (including the financial lease) totals up to KZT845.9 billion.

Kazpost is the only operator of postal services within Kazakhstan. Additionally, as Kazpost also provides financial services including brokerage and agency services, it is considered as a non-banking financial institution. In 2014, Kazpost launched a business transformation program seeking to promote e-commerce through its postal services, including transportation, logistics and financial intermediation for corporate businesses and the public. One of the key advantages of Kazpost is that the institution's services include the most remote settlements of the country and can be the centre of economic activity for those remote areas.

The leasing industry is also one of the most important sectors in the non-banking market whereby one party gains a long-term rental agreement and the other party receives a form of secured long-term debt. According to the "Law of the Republic of Kazakhstan of July 5, 2000, No. 78-II" on financial leasing, the forms and types of leasing are as follows:

- (i) Domestic leasing, whereby the lessor and the lessee are residents of the Republic of Kazakhstan;
- (ii) International leasing, whereby the lessor or lessee is a non-resident of the Republic of Kazakhstan;
- (iii) Lease back, in which the seller sells the leased asset to the lessor with the condition of receiving the leased asset as a lessee;
- (iv) Bank leasing, in which a bank acts as a lessor;
- (v) Full leasing, in which the maintenance of the leased asset and its maintenance are carried out by the lessor; and

⁴⁰ NBK, "Current State of the Non-Banking Sector of Kazakhstan", July, 2019. Available at: <https://nationalbank.kz/?docid=3368&switch=english>

- (vi) Net leasing, whereby the maintenance of the leased asset and its maintenance are carried out by the lessee.

The history of the leasing industry in Kazakhstan can be traced back to three stages. The first stage is characterized by the emergence of businesses and the institution of private property. The second stage is the application of leasing in certain sectors of the economy. The third stage is the adoption of legal standards such as the Civil Code of Kazakhstan 1999, the "Law of Financial Leasing 2000" and the Tax Code in 2001. This legal adoption resulted in some private leasing companies operating until today, including Al Saqr and KIC. This leads to creating and fostering competitive advantages among leasing companies and increase the demand as a financial instrument.

State-owned leasing companies still dominate the leasing market, for example KazAgroFinance (100% state-owned and a subsidiary of KazAgro, a state holding company), Astana Finance Leasing (a subsidiary of Astana-Finance 14.20% owned by the State Property Committee of the Ministry of Finance and 3.92% by the sovereign wealth fund Samruk-Kazyna, as of January 2010) and the DBK's subsidiary, DBK Leasing (100% state-owned). Other major private leasing companies include Halyk Leasing, BTA Orix Leasing, Kazkommertsbank, and Center Leasing.

Meanwhile, Al Saqr was founded in 2000 as a leasing company and was owned by international companies like ORIX and IFC. The company was established before Kazakhstan adopted the first law in the post-Soviet space on Islamic finance in 2009. However, it converted into the Islamic mode of financing, *ijarah*, in 2016 and has fully adopted full-fledged Shari'ah financing in 2017.

Al Saqr has a foreign Shari'ah board (Shariah Review Bureau, Bahrain) to monitor Shari'ah compliance and audit while assisting it to constantly improve on internal procedures and Shari'ah governance process.

Meanwhile, KIC is the first Islamic leasing company in the country. It was established in 2013, attained operational profit within two years and has maintained an operational profit since. The company focuses on financing to Small Medium Enterprises ("SMEs") by providing alternative sources in the form of Shari'ah compliant financing for their projects.

The KIC grew in tandem with the sustainable growth of the national economy. The NPL ratio is recorded below 4%, well below the current market ratio of 9.5% (historically the NPL ratio is 35% for the past two years due to the banking system's instability). Shareholders of the KIC comprise of IDB (36%), Al-Hilal Bank, Aktif Bank (Turkey), Zaman Bank, Kolon World Investment Co. (South Korea) and Eurasia Group AG respectively.

The KIC gives preference to financing the transportation sector (mainly railroad projects) and in the construction sector. In the construction sector, road construction projects are preferred and currently housing constructions are limited to not more than 12%, with financial leasing and (pure) *murabahah* products offered.

Apart from the KIC, the DBK is another non-banking financial institution and focuses on developing the non-primary sector of the economy in this country. The establishment of the DBK was based on "Decree No.531 on the Development Bank of Kazakhstan" of the First President Nursultan Nazarbayev dated 28th December 2000. It remains as the only institution to develop the national economy through investments in the non-resource sector of the country.

The role and function of the DBK ideally depends on demand. First, DBK provides a platform for debt capital issuances, in line with the Article 13 of the "Law of the Republic of Kazakhstan on the Development Bank of Kazakhstan" dated 25th April 2001 on 'Procurement of Loans' by the DBK, which states that the DBK has the right to entrust its agents all or part of the operations related to placements, repayment of securities and other debt obligation as well as interest payments. Second, the DBK also promotes trade finance, fund raising and investment relations⁴¹.

⁴¹ Government Decree No. 659 on the Incorporation of the Development Bank of Kazakhstan Closed Joint Stock Company dated 18th May 2001.

Half of the borrowing portfolio is from the debt capital market and bilateral financial institutions due to market demand. It is recorded that the majority of DBK's customers are private companies in manufacturing (75%) and infrastructure projects (25%) respectively. The NPL ratios were recorded at 0.5%.

As per audited report of KIC by Ernst & Young for 2018: ROA = 9.8%, ROE = 11.5%. According to the KaSE⁴² as of 1st July 2019, Al Saqr had KZT4.6 billion of total assets and KZT1.0 billion of total liabilities, with an earned net income of KZT114 million with return on assets (ROA) 2.49%.

Microfinance institutions are non-banking operations which have also recorded remarkable growth and development. The landscape of microfinance has been transforming in the last few decades. It started as a microcredit institution; a simple service providing micro-loans to unbanked people and has turned into a complex financial market involving many microcredit organizations (MCO) and microfinance institutions (MFI). Their products and services are aimed towards helping low-income people in addressing credit and saving needs with manageable risk and efficiently executed transactions.

TABLE 9: STRUCTURE OF THE MICROFINANCE INSTITUTIONS

Level	Actors
1	Non-banking financial institution
2	Credit partnership
3	Micro credit organization
4	Microfinance institutions

As of 1st January 2020⁴³, the microfinance sector is represented by 199 MFIs with total assets of KZT355.2 billion, 82.5% of which are in the form of microcredits. The liabilities of the MFIs are mainly created by received loans at 70%. The total income for MFIs was a positive net profit of KZT23.2 billion.

The ARDFM is currently the regulatory body for MFIs in Kazakhstan, although historically this was not the case until the coming into force in 2012 of the "Law on Microfinance Organisations" (which was adopted in 2003). Curiously, the wordings "microfinance organization" were omitted although by 1st January 2012, there were already 1756 MCOs and 663 of them are active. Thus, while all MFIs should go through registration in the regional branches of the ARDFM, those deemed as MCOs are not. Since then however, many MCOs are either in the process of registration as MFIs, transformation into pawnshops and non-financial organizations or under the process of liquidation. It should be pointed out that according to Kazakhstan legislation, any legal entity in the form of LLCs may give loans to its participants, employees or third parties. The purposes of providing such credit facilities are:

- To handle urgent needs, e.g. medical treatment;
- To make payments of expensive purchases, tuition, travel expenses; or
- To repay loan.

Thus, there is a deep concern that MCOs may transform themselves into non-financial entities which will continue to provide credit facilities without any regulations.

Today, some MFIs collaborate with umbrella organisations such as the Association of Microfinance Organizations ("AMFOK") and there are 33 microfinance operators registered under the AMFOK, in which Kazakhstan Microfinance ("KMF") has the largest market share with 33%. Other big players of microfinance are Toyota Financial Services, ASEAN Credit Funds, Bilikya Micro finance and others. 53% of the loans are allocated for trading (entrepreneurship activities) and 60% of the individual customers are from the rural regions.

⁴² Kazakhstan Stock Exchange (KASE). Accessed from: <https://kase.kz/en/issuers/ALSF/>

⁴³ ARDFM, "Current State of Microfinance Organizations of Kazakhstan", January, 2020. Available at: <https://nationalbank.kz/?docid=797&switch=english>

Co-operatives are also an important market in the non-banking sector, aimed at addressing the needs of the agricultural sector for funding. Agricultural co-operatives can help subsistence-oriented households shift to small-scale commercial farming and overcome challenges caused by high transaction costs and the significant spatial dispersion of production.

As of 30th June 2018, Kazakhstan registered a total of 2,872 agricultural co-operatives and 62,825 member-farmers (Committee on Statistics, 2018). The extent to which farmers are involved in co-operative enterprises remains limited: the number of co-operative members divided by the total number of farm holdings stood at just 3.4%.

The co-operative organizations are governed under several laws such as "Law no. 372-V on Agricultural Co-operatives" which was adopted on 29th October 2015. This is in addition to the pre-existing laws which have been enforced, such Production Cooperative, 1999; "Law of Rural Consumer Cooperation in 1999", "Law of Consumer Cooperatives, 2001"; and "Law of Rural Consumer Cooperatives of Water Users, 2003".

8.2 ISSUES AND CHALLENGES

Non-banking institutions are beset by a lack of funding sources. Conventional banks cannot provide them with the funding they need in KZT as they cannot have windows nor can the conventional banks structure any Islamic products directly on their own.

The law also does not allow leasing products to individual customers; leasing is to be limited to purely business purposes. Article 565 of the "Civil Code of Kazakhstan" states that "under a leasing agreement the lessor undertakes to purchase the facility to be leased *for business purposes*."

Lack of awareness and understanding about Shari'ah compliant leasing remain among the barrier to more dynamic and better market penetration of this sector.

Lack of expertise, particularly on Shari'ah knowledge, is pertinent issue in leasing institutions. The number and quality of experts who could contribute towards improving the performance of this sector over the long term need to be increased. Upgrading the expertise in this sector would be a long time process, and the government have recruited more foreign experts. Strategic policies ought to ensure fulfilling the need of expertise becomes the concern of all stakeholders including policy makers from various governmental agencies directly and indirectly involved in its implementation, regional and local municipalities, financial services providers, business communities, civil society including NGOs.

The leasing sector is considered relatively small in terms of volume since it has a small number of operators, especially the companies which operate using Shari'ah principles. There is a lack of Islamic financial instruments as a source of funds including the economic cycle, the use of unsustainable international loans and unstable high exchange rates.

It is necessary to take measures to provide tax exemption for all types of leasing, including *ijarah* based transactions. For this purpose, it is pertinent to understand clearly the definition and nomenclature of financial leasing in both taxation and civil legislations. For example, Article 565 states that "*Under a leasing agreement the lessor undertakes to purchase the property indicated by the lessee from the seller and then rent this property to the lessee for temporary use and ownership of the property for business and for an indicated payment*", thus limiting other types of leasing including *ijarah* based transactions. There is no VAT exemption for *ijarah* based transactions.

The DBK currently encounters human capital issues particularly to respond to the challenges of Islamic financial industry. In line with Article 5 on "Powers of the Development Bank", sub paragraph 2 that was amended by the "Law of the Republic of Kazakhstan" dated 29th October 2015 enables the DBK to attract experts and advisors to carry out the bank's examination. The main objective of this initiative is in line with Article 4 on the Functions of the DBK which requires its interaction with international and national development institutions, an organization within the implementation of the state program.

The interaction is needed as the international market does not understand clearly about Kazakhstan and its financial structure in general as well as its banking industry in particular.

The Memorandum on the Credit Policy of JSC DBK Section 4.4 pertaining to “Financing of Investment Projects and Export Operation” clearly states that project financing is carried out by issuing loans or borrowing bonds. Investors easily understand the process and procedures of bond issuance but not those of *Sukuk*. Familiarity in terms and conditions of *Sukuk* is a barrier to investors and to fulfilling domestic demand through *Sukuk* issuances. Furthermore, KaSE does not have a platform for Islamic instruments that exacerbates the difficulty in raising capital and leading to a lack of Shari’ah compliant funds in the market.

There is no Islamic microfinance institution operating in Kazakhstan, although there is some evidence that financial and non-financial institutions have come up with micro-financing programs based on Shari’ah principles. The legal framework for microfinance organisations currently does not enable Islamic finance.

Microfinance institutions may not operate as joint stock companies, which restricts their ability to bring in additional shareholders, expand their equity base, or diversify ownership away from single owner-operator structures.

Since 2017, the communication policies of the regulator begun focusing on how to increase public awareness and understanding, including on microfinance. However, the knowledge and potential on Islamic microfinance was not touched upon. Today, the government is still trying to enhance cooperation with the Organization for Economic Cooperation and Development to build-up a competitive financial sector to increase the financial literacy of the population. There is a 3-years project initiated not only by Kazakhstan but also by the surrounding countries on financial education to enable all countries to work out how to implement, assess and execute more effective national strategies in enhancing financial education. Nevertheless, this initiative also does not include Islamic microfinance as a subject matter.

As microfinance requires the right human capital, particularly in addressing Shari’ah principles, the lack of human resources who possess the appropriate competence and credentials remains an obstacle the expansion of this sector and benefitting a substantial part of the population.

Kazpost’s services include payments, transfer to card, exchange rates, payment card issues and provisions of loans. However, none of these facilities utilizing Shari’ah principles or offer Islamic accounts for corporates or individuals. As Kazpost is the only financial service provider that can reach the remote areas in the country and since the majority of the population are Muslim, it is important to enable Shari’ah compliant Kazpost financial services.

Note that leasing companies due to their nature, are relatively easy to transform into Shari’ah compliant operations. The nature of leasing and their legal documentations only require few modifications to be aligned with Shari’ah principles. Regulatory authorities may facilitate the conversion of state owned leasing companies and also securitization of their assets in a Shari’ah compliant manner. These measures will lead to an increase in the total Islamic financial assets of the country.

8.3 RECOMMENDATIONS

Strategic Initiatives	Recommendations
1. Strengthen the supervisory and regulatory framework for the non-banking sector.	<ul style="list-style-type: none"> i. Amend the laws to enable and facilitate Islamic microfinance; ii. Review the tax framework for non-bank financial institutions to enable and facilitate their Islamic financial transactions;

	<ul style="list-style-type: none"> iii. To enable Islamic windows which can access funding from the banking sector.
2. Enable and develop adequate infrastructure for Islamic non-banking services.	<ul style="list-style-type: none"> i. Introduce Shari'ah compliant microfinance institutions, Islamic cooperatives and Kazpost services; ii. Establish an Islamic liquidity platform, such as Islamic interbank money market and commodity <i>murabahah</i> platform, in KZT as to manage currency risks; iii. Promote and facilitate the issuance of Islamic securities for non-banking sectors; and iv. Leverage on FinTech for funding and financing processes.

8.3.1 STRATEGIC INITIATIVE 1 STRENGTHEN THE SUPERVISORY AND REGULATORY FRAMEWORK FOR THE NON-BANKING SECTOR

(i) Amendments to the Laws

The microfinance sphere is ahead of the banking sector in terms of development rate in Kazakhstan. In 2017, microfinance grew at 50% compared to banks which grew at 10% in the same year. The quality of microcredit also remains high compared to banks. The bad debts of banks accounted for 12.7% of its loan delinquency over 90 days compared to micro finance institutions, which was only 4.6%. The lending market of Kazakhstan also changes to micro credit as many factors such as high demand for online credit, devaluation of the KZT and tight bank credit. Microfinance companies have become the driver of the credit market of Kazakhstan.

However, regulation of the microfinance sphere requires legal breakthrough as the process and procedures remain tougher over the past years compared to a bank. Microfinance laws require amendments to enable and facilitate Islamic microfinance.

(ii) Review the VAT for Islamic financial transactions

According to Article 540 of the "Civil Code of Kazakhstan" property renting includes leasing agreements. However, the above Article also states that leasing is a sale agreement which is in line with Article 74, which considers such transactions a purchase of a fixed asset by the lessee. Therefore, leasing and sale transactions are equally subject to the VAT and the taxable base is the same in both cases.

The issue of double taxation of the rental property when paying VAT remains the burden on the lessee since it causes the increase of costs significantly and in turn leads to discouraging the development of enterprises particularly for small and medium business. As such, it is important to review the VAT for Islamic financial transactions such as *murabahah* and *ijarah* and product structures involving a combination of multiple Shari'ah contracts.

Murabahah and *ijarah* are Shari'ah contracts based on the sale and purchase and leasing principles, respectively. Therefore, Article 74 will certainly cause double taxation for both types of transactions.

(iii) Microfinance as JSCs

The microfinance sector in Kazakhstan is still considered underdeveloped compared to other financial institutions. Its operations, financial reporting and governance are in largely Almaty city and the south of

Kazakhstan. Microfinance institutions in Kazakhstan may be established as microloan organizations (either as a for-profit or non-profit organizations), or credit partnerships (which are similar to credit unions). Before the enactment of the “Law on Micro Loan Organization” in 2003, some MFIs were registered as non-bank financial institutions. None of these organizational forms is permitted to take deposits from the public.

The government may consider microfinance institutions as a part of the formal financial sector. Their operation and legal status need be considered as the other financial institutions. It may be timely to enable MFIs to operate as JSC.

As a JSC, an MFI may operate as a bank since currently most of them do not have the technical financial base to transform their operations like a bank. Since 2008, MFIs were unable to diversify its ownership structure like a bank could. The Association of Microfinance Organizations (“AMFOK”) has forwarded some recommendation to improve the legal framework that affects MFIs including to allow MFI as joint-stock companies enable them to issue bonds or *Sukuk*.

8.3.2 STRATEGIC INITIATIVE 2 ENABLE AND DEVELOP ADEQUATE INFRASTRUCTURE FOR ISLAMIC NON-BANKING SECTOR

(i) Introduce Islamic microfinance institutions, cooperative and Kazpost services

It is important to introduce Islamic microfinance as part of the financial sector. The existence of Islamic microfinance will meet the Muslim need for Shari’ah compliant products in this sector, and as an alternative to the conventional loans.

There is also a need to enable a Shari’ah compliant cooperatives in particular to facilitate parties involved in the agricultural sector who are interested in Islamic financing.

Kazpost also plays a vital role in this sector since they are providing financial services for businesses and the public through its postal services. Shari’ah compliant Kazpost products will enable Islamic finance to reach the rural areas and the wider population of Kazakhstan, and might increase financial inclusion.

In 2016, the Student Loans Company in the United Kingdom has been looking into the possibility of introducing a Shari’ah compliant funding system for students to finance their tuition fees at universities. This alternative student funding is based on the *takaful* structure and the money held in these accounts will not be invested in industries such as gambling, alcohol or weapons manufacturing. The proposed *takaful* fund would not be interest based, but would result in identical repayments to the current student loan system. The United Kingdom government had agreed to develop the *takaful* financial product to which it has also received preliminary approval from Al Rayan’s Bank Shari’ah supervisory committee.

(ii) Establish an Islamic liquidity platform

The establishment of an Islamic liquidity platform would address the needs of the industry in the capital market, corporate finance, trade finance, and also non-banking institutions. Since Kazakhstan is susceptible with currency devaluation risks especially amid banking crises, the use of KZT in this platform such as an Islamic interbank money market and Commodity *Murabahah* will provide more liquidity in the market. The use of KZT in this regard is mainly to manage currency risks and strengthen KZT, particularly to meet domestic demand for KZT, which is a pressing issue.

(iii) Promote the issuance of Islamic securities for the non-banking sector

Since most of the non-banking institutions are operating not as JSCs, mobilizing funds and liquidity remains an issue. To provide wide financial options for the corporate sectors, Islamic securities should be facilitated and regulated accordingly to fulfil the need for liquidity and obtain a diversified source of funding.

(iv) Leverage on financial technologies

FinTech in financial services paves the way for optimal efficiency and effectiveness. The existence of FinTech today can be adopted in various forms including for Islamic finance for example through P2P platform using blockchain technology. FinTech will enable reach to the remotest areas of the country.

8.4 ACTION PLAN

8.4.1 STRATEGIC INITIATIVE 1

STRENGTHEN THE SUPERVISORY AND REGULATORY FRAMEWORK FOR NON-BANK SECTOR

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to amend the laws to enable and facilitate Islamic microfinance.						AIFC Authority, ARDFM, Ministry of Finance, AFSA
2.	Review the tax framework for non-bank financial institutions to enable and facilitate their Islamic financial transactions.						AIFC Authority, ARDFM, Ministry of National Economy, Ministry of Finance, AFSA
3.	Suggest to enable Islamic windows so they can have access to the funding from the banking sector.						AIFC Authority ARDFM, AFSA

8.4.2 STRATEGIC INITIATIVE 2

DEVELOP ADEQUATE INFRASTRUCTURE FOR ISLAMIC NON-BANKING SECTOR

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to introduce Islamic cooperatives and Kazpost services.						AIFC Authority, ARDFM, Kazpost, AFSA
2.	Suggest to facilitate the issuance of Islamic securities for the non-banking sector.						AIFC Authority, AIX
3.	Suggest to leverage on FinTech for funding and financing processes.						AIFC Authority, Industry players

CHAPTER 9: ISLAMIC SOCIAL FINANCE

9.1 INTRODUCTION

In November 2018, 28 world's leading banks agreed to establish the "Principles for Responsible Banking" under the United Nations Environment Programme – Finance Initiative (UNEP-FI). This initiative marks a significant shift in the current financial regime toward a more responsible and sustainable financial system. The banking entities have begun reconsidering their orientations from solely profit-oriented institutions towards being more socially and environmentally conscious, through the principles of responsible finance.

Islamic social finance, being an important responsible and sustainable instrument, has in recent years gained increasing attention from many central banks, governments and financial institutions, considering it as an essential enabler for financial inclusion. A plethora of literatures confirm that that Islamic finance could contribute to financial inclusion via two financial inclusion mechanisms: Firstly, through promoting the profit and loss sharing (PLS) concept as an alternative to conventional debt-based financing; and secondly, through social finance such as *zakat* (obligatory alms-giving), *sadaqah* (voluntary charity), *waqf* (endowment), and *qard hasan* (benevolent loan), which complement the PLS instrument⁴⁴.

Social finance, mandated or otherwise, is an integral part of the Islamic financial system to offer equal opportunity to financial access. The underserved and poor are particularly supported: "so that it may not (merely) make a circuit between the wealthy among you" (Quran, 59:7).

Choudhury (2001) argued that for attaining a heightened level of impact on poverty alleviation, human resource development and income generation, the sustainability of the Islamic social finance must be combined with other productive financial instruments such as profit-sharing, equity participation, joint ventures and co-financing⁴⁵.

9.1.1 ZAKAT ADMINISTRATION IN KAZAKHSTAN

Kazakhstan is a secular country which, by law, segregates religion and state. Nevertheless, the country has introduced a single apex institution, namely the Kazakh Muftiate that is also known as the Spiritual Administration of Muslims of Kazakhstan ("SAMK"), to facilitate and administer the practising of Islamic faith in Kazakhstan which predominantly is of the Hanafi school of Islamic jurisprudence.

The SAMK supervises the full spectrum of Islamic matters in Kazakhstan, including the administration of *zakat*, the construction and maintenance of mosques, propagation of Islam, administration of *hajj* (pilgrimage), *halal* certification, issuance of *fatwa*, establishment and management of Islamic schools and research centres, as well as the establishment of charities and funds. To support its role and functions, the SAMK established several departments such as the Press Department, Department of International Relations, Department of Shari'ah and Fatwa, Department of Education and Training, Department of Religious Affairs and Analysis, Department of Propaganda and Public Relations, Department of Mosques, *Hajj* Department, Publishing and Translation Department, Department for Charity Fund and Wakif and the Human Resource Department.

Established in 2011, the *zakat* department serves as the main administrative body for the collection, administration and distribution of *zakat* funds in the country. It facilitates the Kazakh Muslim individuals and business entities, to pay their *zakat* obligation based on the Shari'ah-prescribed rate. The department is also mandated to promote the obligation of *zakat* payment on self-imposed *zakat* (*zakat al-fitr*) or *zakat* on wealth (*zakat al-maal*). During the first two years of its activities, the *zakat* department managed to collect a total of KZT52.7 million (US\$ 152,000), which were donated by businesses and individuals⁴⁶.

⁴⁴ M. Mohieldin, Z. Iqbal, A. Rostom, & X. Fu, "The Role of Islamic Finance in Enhancing Financial Inclusion in Organization of Islamic Cooperation (OIC) Countries", *Policy Research Working Paper 5920*.

⁴⁵ M. Alam. Choudhury, *Financial Globalization and Islamic Financing Institutions: The Topic Revisited*. Islamic Economic Studies, 9 (1), 2001, pp. 19-38.

⁴⁶ M. Obaidullah, & N. S. Shirazi. *IRT1 Islamic Social Finance Report 2017*.

The *zakat* department of SAMK outlined the priority of *zakat* beneficiaries to ensure that *zakat* funds are channelled to deserving beneficiaries. They are as follows:

1. Financial assistance for low-income categories, big (with many children) families, widows, and children suffering from the various diseases, including cerebral palsy, cancer, autism and other serious diseases in the form of cash, food, clothing;
2. Payment of religious leaders' salaries in rural mosques and scholarships to students of religious schools in Nur-Sultan;
3. Providing the necessary material and resources for teaching and replenishing the technical training institutions database; and
4. Allocation of funds for the production of publications on various religious topics, information sheets for distribution to the population.

In practice however, the *zakat* fund was overwhelmingly used for the salaries of religious leaders (*Imams*) and to repair mosques. Since early 2013, over 200 Imams benefitted from the *zakat* fund, with a monthly salary of KZT20,000 (US\$59) each, absorbing the total annual salary expenditure of KZT48 million⁴⁷.

9.1.2 WAQF DEVELOPMENT IN KAZAKHSTAN

The present state of *waqf* in Kazakhstan is unorganised. There are currently around 2,404 mosques and 12 religious educational institutions (9 madaris or Islamic schools), two training centres for Quran reciters, one advanced training institute for Imams and one institute for religious culture) in Kazakhstan, which can be deemed as *waqf* properties⁴⁸. The SAMK building is also *waqf* property. It is a common practice in Kazakhstan that people raise funds to build religious premises (mosques or madaris). There are also some social and infrastructural projects, the information about which is not available as the donors wish to keep their religiosity undisclosed in a secular environment.

The idea of having formal *waqf* institution in the country began materializing when, in 2017, Nur-Sultan jointly with the SAMK hosted the launch of the "Kazakhstan Fund "Uakhyp" Corporate Charity Fund, a non-profit charitable organization to support the construction and maintenance of religious buildings and social facilities, supporting the Imams and the poor, unemployed and disabled. In 2018, The charity fund managed to assist more than 300 lower-income individuals living in remote areas. Currently, Uakhyp is also participating in the construction of a 4-storey residential building for socially vulnerable segments of the population of Aktobe.

Apart from that, Abu Dhabi al-Khairiyya Foundation, a foundation centred in Kuwait, opened a representative office in Kazakhstan. The foundation focuses on the building of mosques and children's homes and provides charity work during *Ramadhan*, *Qurban-eid* and *Oraza-eid*. It also supports several lyceums and organizes Arabic lessons. *Waqf al-Islamiyya*, the Saudi Arabia-owned foundation, has also opened a representative office in Kazakhstan and focuses on charity work, such as funding support for a boarding school (internat) in the city of Kapchagai.

9.1.3 REGULATORY AND SUPERVISORY FRAMEWORK FOR ZAKAT AND WAQF IN KAZAKHSTAN

The *zakat* and *waqf* systems in Kazakhstan do not have specific legislative support, a regulatory body or any regulatory system. Nevertheless, the regulatory framework of Kazakhstan relating to charities in general, allows Islamic social finance institutions to operate within a secular legal framework. Among the relevant laws that could substantiate the establishment of Islamic social finance institutions are as follows:

1. The "Law of Republic of Kazakhstan on Charity" dated 16.11.2015 No. 402-V;
2. The "Law of Republic of Kazakhstan on Non-commercial Organizations" dated 11.10.2011;
3. The "Law of Republic of Kazakhstan on Religious Activities and Religious Associations" dated 11.10.2011;

⁴⁷ *ibid*

⁴⁸ *ibid*

4. The Civil Code of the Republic of Kazakhstan;
5. The Tax Code of the Republic of Kazakhstan; and
6. Other supplementary laws.

According to the Kazakh legislation, charity is a social activity which is performed willingly and gratuitously to facilitate people's need or for public interest. Based on this definition, the law allows both businesses and individuals to form a Charity Organisation ("CO") and participate in business activity for profit-making, but such profits must be designated for charity work and cannot be distributed among the founders.

A CO may accumulate assets from the following sources:

- a) donations, testaments, gratuitous conveyance of property and the rights on it;
- b) voluntary contributions;
- c) profits from charitable auctions and competitions;
- d) endowments;
- e) business activity profits;
- f) benefactor's yield from some performed works,
- g) services or results of personal creative activity;
- h) objects of public charity recovered from benefactors; and
- i) other sources stated by the law.

The assets/profits may also be utilized for:

- a) One-time or multiple charity support during the year;
- b) Long-term charity support;
- c) Assistance in social advertising;
- d) CO activity; and
- e) Other activities stated by the Kazakhstan's laws.

9.2 ISSUES AND CHALLENGES

(i) Absence of a Dedicated Regulatory Framework

Operating in a secular jurisdiction, *zakat* and *waqf* systems encounter a plethora of complex issues and challenges. Foremost is the absence of a dedicated regulatory framework governing the administration of *zakat* and *waqf* in Kazakhstan. This results into unorganised administration, ineffective collection and distribution as well as untapped potential of both funds.

(ii) Inadequate number of *zakat* and *waqf* institutions

The absence of clear guidelines and framework on the administration of both *zakat* and *waqf* results in inadequate number of *zakat* and *waqf* institutions that could facilitate sufficient collection and distribution points of *zakat* and *waqf*. Currently, the collection and distribution of *zakat* are only administered by a special department under the SAMK with limited resources and capacity thus leading to negligible *zakat* collection and even less formal development of *waqf*.

(iii) Lack of Literacy and Understanding of Islamic Social finance Instruments amongst the Population

Another substantial issue facing the development of *zakat* and *waqf* systems in Kazakhstan is the lack of literacy and understanding of Islamic social finance instruments in all segments of the population. The talent pool and expertise in Islamic social finance is also negligible at both policy, regulatory and industry level. As a result, *zakat* and *waqf* institutions experience lack of institutional trust from the public, resulting in inefficient

mobilization of *zakat* and *waqf*. Rather than contributing *zakat* via the SAMK, Kazakh Muslims prefer to pay *zakat* directly to the recipients. Similarly, instead of establishing a *waqf* fund to develop education, healthcare, infrastructure on a sustainable basis, rich Muslims in Kazakhstan prefer to give *sadaqah* to poor or needy people directly. On top of that, there is some misconception in the public at large that *zakat* is only compulsory on *zakat fitrah* (self-imposed *zakat*) during Ramadhan, with the exclusion of *zakat* on wealth. Many Kazakh Muslims also believe that *zakat* is only compulsory for individuals and not on businesses.

The future outlook of Islamic social finance in Kazakhstan

The future of *zakat* and *waqf* in Kazakhstan is, nevertheless, promising for a number of reasons: Firstly, the SAMK under the *zakat* department has introduced an online *zakat* platform which facilitates easy *zakat* payment. Secondly, as a charitable organization, *zakat* and *waqf* institutions are eligible for tax exemptions. According to Article 134 of Kazakhstan’s Tax Code, the profit of a non-commercial organization received in the framework of commissioning of social services in the form of bank deposit interests, grants, admission and membership fees, charity support, property obtained on a non-repayable basis, gratuitous contributions and donations are not liable for corporate tax.

Thirdly, most of Kazakh people are Muslim (70.2%) with an increasing number of mosques in the country. This fact is further supported by a growing awareness of religion among the younger generation. Fourthly, *waqf*, according to the overwhelming majority of Muslim jurists, requires perpetuity and there is no restriction on such in the law (unlike the federal law in Russia for example). According to the Civil Code, for the contracts of uncompensated use of the property contract term (tenor), the rules of rent contracts are applied. According to paragraph 1 and 2 of Article 545 of the Civil Code, the contract may be concluded for a fixed term or an indefinite period and provides for the transfer of right in perpetuity. At the same time, both parties of the contract have the right to terminate the contract prematurely on certain grounds or by agreement of the parties without reason.

9.3 RECOMMENDATIONS

The analysis of the *zakat* and *waqf* infrastructure in Kazakhstan suggests that its current development is unsystematic and not well organized. Moreover, neither the overarching regulatory system nor professional *zakat/waqf* regulatory bodies that provide legal, Shari’ah, and operational requirements of the *zakat/waqf* management in Kazakhstan are established. The regulatory framework of Kazakhstan in relation to charities (*zakat* and *waqf*) is merely within the ambit of secular law and does not specifically address the legal, Shari’ah, and operational features of *zakat* and *waqf*. It is, therefore, submitted that strategic and action plans of the Shari’ah, legal, operational, and governance framework of the *zakat* and *waqf* are timely and imperative to strengthen the role of Islamic social finance within the Islamic financial system in support of the agenda of financial inclusion and social protection. Such an initiative will hopefully create an impact with promising results of not only social goals but also environmental and economic sustainability.

As far as *zakat* is concerned, we propose and recommend the following to enhance the development of *zakat* and *waqf* in the country:

ZAKAT	
Strategic Initiatives	Recommendations
1. Establish and facilitate an enabling environment for a <i>zakat</i> ecosystem.	<ul style="list-style-type: none"> i. Establishment of a national <i>zakat</i> centre/institution; ii. Creation of a <i>zakat</i> collection and distribution representative in each region; iii. Creating a comprehensive <i>zakat</i> database (unified data centre);

	<ul style="list-style-type: none"> iv. Forming strategic partnerships and collaborations with relevant stakeholders to promote different type of <i>zakat</i> obligations; and v. Integrating <i>zakat</i> with Islamic financial system via partnership.
2. Promote <i>zakat</i> to support social protection system and financial inclusion.	<ul style="list-style-type: none"> i. Exploring the use of <i>zakat</i> funds for government financial aid program; and ii. Forming a partnership with the Ministry of Labour and Social Protection, etc.
3. Develop adequate <i>zakat</i> infrastructure.	<ul style="list-style-type: none"> i. Leveraging on financial technology in the collection and distribution of <i>zakat</i>; ii. Optimization of an online <i>zakat</i> platform; iii. Introducing a <i>zakat</i> performance indicator (such as integrating International Organization for Standardization (ISO) certification); and iv. Ensuring greater Shari'ah governance and compliance by establishing a Shari'ah committee or appointing a Shari'ah advisor for <i>zakat</i> institutions.
4. Develop a robust <i>zakat</i> regulatory framework.	<ul style="list-style-type: none"> i. Facilitate the introduction of a dedicated regulatory framework; ii. Treating <i>zakat</i> as an income tax rebate; and iii. Adoption of international best practices i.e. <i>Zakat</i> Core Principles and <i>Zakat</i> Criteria for performance Excellence.
5. Enhance the competencies of the <i>zakat</i> collectors (' <i>amil</i>).	<ul style="list-style-type: none"> i. Setting a minimum qualification for '<i>amil</i>, certified <i>zakat</i> collector program; ii. Intensify training and education program for '<i>amil</i>; and iii. Actively engage and participate in international networks on <i>zakat</i>.
6. Increase public awareness on the importance of <i>zakat</i> obligation.	<ul style="list-style-type: none"> i. Creation of a national campaign on increasing public understanding of <i>zakat</i>.

WAQF	
Strategic Initiatives	Recommendations
1. Facilitate the offering of diverse <i>waqf</i> models.	<ul style="list-style-type: none"> i. Establishing a national <i>waqf</i> body; and ii. Introduce <i>waqf</i> institutions/centres in each region.

2. Promote <i>waqf</i> as an engine of economic growth.	i. Utilizing the <i>waqf</i> instrument as a government funding instrument.
3. Create enabling and conducive regulatory environment.	i. Introduce specific <i>waqf</i> legal framework; and ii. Adoption of international best practices for <i>waqf</i> administration such as <i>Waqf Core Principles</i> .
4. Increase the level of awareness and literacy on why <i>waqf</i> can supplement social financing.	i. Develop a framework for awareness programs leveraging on currently available infrastructures such as mosques and <i>madaris</i> as a centre for <i>waqf</i> literacy.

ZAKAT

9.3.1 STRATEGIC INITIATIVE 1 ESTABLISH AND FACILITATE AN ENABLING ENVIRONMENT FOR A ZAKAT AND WAQF ECOSYSTEM

(i) Establishment of a national *zakat* centre

Kazakhstan has established its *zakat* department under SAMK since 2011. However, the *zakat* collection is a far cry from its full potential due to specific issues surrounding its administration. Based on the 2017 *Zakat and Waqf Report*, Kazakhstan's potential *zakat* collection stood at 3.05% of the country's GDP. To achieve its potential, it is imperative to ensure that the *zakat* management and administration is consolidated under a dedicated national *zakat* centre. The *zakat* department of SAMK should be established and formalised as an independent central institution—beyond being a department within SAMK to administer and oversee *zakat*, *waqf* and other Islamic welfare institutions through effective governance structures. This is to ensure effective philanthropic contributions and mobilisation and enhance the potential of *zakat* management in the country. It is anticipated that the systematic and consolidated *zakat* administration will promote a systematic and professional approach in managing the *zakat* fund.

(ii) Creation of a *zakat* collection and distribution representative in each region

Moving forward, the national *zakat* centre should also establish *zakat* representative offices in each region of Kazakhstan to achieve optimal mobilisation of the *zakat* funds. This representative office should be mandated to mobilise *zakat* funds from the public, including self-imposed *zakat* (*zakat al-fitr*), *zakat* on wealth (*zakat al-maal*), individual *infaqlalms*, *zakat* on corporations (corporate *zakat*), *waqf*, and institutional *infaqlalms* including corporate social responsibility (CSR). The office should also be authorised to distribute *zakat* and other Islamic social funds to the deserving beneficiaries, for both social goals and productive purposes. This productive *zakat* seeks to empower the eligible *zakat* beneficiaries so they may sustain their financial needs over the long term and elevate their level to *muzakki* (*zakat* payer) as a result.

(iii) Creating a comprehensive *zakat* database (unified data centre)

The national *zakat* centre is also advised to develop a comprehensive *zakat* database (one data centre) encompassing *zakat* statistics, research, publications, and regulations of *zakat*. This will help the government and other stakeholders to assess the performance, *zakat* statistics, trend and other relevant *zakat* information in the country.

(iv) Forming strategic partnerships and collaborations with relevant stakeholders to promote different type of *zakat* obligations

Aside from that, a partnership between *zakat* institutions, government bodies and other relevant stakeholders, is also imperative to promote different types of *zakat* obligations. Indeed, the vast potential of *zakat* may not be optimally accomplished without this support. The collaboration amongst these institutions may complement each other to accelerate the development of the *zakat* institution.

(v) Integrating *zakat* with Islamic financial system via partnership

In particular, the partnership with financial institutions for effective and efficient mobilisation of *zakat* finds its high significance as a platform to integrate both commercial and social finance. As an important component of Islamic social finance instruments, the *zakat* system should be integrated with the Islamic financial system. There are excellent examples of such integration in other jurisdictions i.e. Malaysia and Indonesia, such as *zakat* collection through internet banking, *zakat* deduction from saving accounts, and a *zakat* payment option from the central depository system (CDS) account at the stock exchange.

9.3.2 STRATEGIC INITIATIVE 2

PROMOTE *ZAKAT* TO SUPPORT SOCIAL PROTECTION SYSTEM AND FINANCIAL INCLUSION

(i) Exploring the use of *zakat* funds for government financial aid programme

Zakat as an Islamic social protection system aims to provide financial support to the deserving categories such as the poor and underserved. Therefore, the institution of *zakat* in Islam can be designed to support the government's social protection system. For example, *zakat* can serve as the supporting funding source of a government financial aid program for the low-income segment. The *zakat* fund can also serve as one of the main funding sources to provide financial support to the most vulnerable segment of society, children of 0-2 years, under children-sensitive protection system. A plethora of academic evidence also confirms that *zakat* can also promote financial inclusion to provide financial access to those unbanked and underserved.

(ii) Forming a Partnership with the Ministry of Labour and Social Protection

In this regard, it is recommended that the *zakat* department of SAMK initiates partnerships with the relevant government institutions such as the Ministry of Labour and Social Protection to explore its viability as social protection system and to support the financial inclusion agenda. For example, *zakat* funds are used as a funding source for government's financial aid program addressing the rising living cost of the lower income segment. *Zakat* can also be designed to support the need of the children in Kazakhstan in terms of sustenance, nutrition, healthcare and education. For example, universal child grant for their first 1,000 days which is the most vulnerable phase in children's lives, in which nutrition and beneficial healthcare are paramount.

One of the Islamic social protection systems that has been explored in Malaysia is a free *takaful*/health protection scheme, which provides *takaful* protection for underprivileged individuals in the B40 income group via the MySalam trust fund. This initiative is a collaboration with an insurance provider, Great Eastern Holdings, who contributed an initial seed funding of RM2 billion to the MySalam trust fund. This collaboration is an exemplary instance of a credible PPP model aimed at building a better social protection network for the Malaysian public. This scheme will be initially offered by Great Eastern *Takaful* Berhad, a *takaful* operator regulated by Malaysia's central bank.

In 2016, the Student Loans Company in the United Kingdom has been looking into the possibility of introducing a Shari'ah compliant funding system for students to finance their tuition fees at universities. This alternative student funding is based on the *takaful* structure and the money held in these accounts

will not be invested in industries such as gambling, alcohol or weapons manufacturing. The proposed *takaful* fund would not be interest based, but would result in identical repayments to the current student loan system. The United Kingdom government had agreed to develop the *takaful* financial product to which it has also received preliminary approval from Al Rayan's Bank Shari'ah supervisory committee.

9.3.3 STRATEGIC INITIATIVE 3 DEVELOP ADEQUATE ZAKAT INFRASTRUCTURE

(i) Leveraging on financial technology in the collection and distribution of *zakat*

The enabling environment for the *zakat* ecosystem can only be achieved if the necessary infrastructure is in place. In the regard, it is necessary to put in place the adequate infrastructure required for the effective *zakat* administration in the country. The advancement of digital technology should be utilized in the process of *zakat* collection, distribution, and management. The *zakat* collection and distribution should subscribe to a digital platform to raise *zakat* funds, which can be done in various channels such as online crowdfunding, digital payment machines, QR codes, and even blockchain. The optimal utilisation of an online *zakat* platform initiated by the *zakat* department of SAMK will facilitate easy payment of *zakat*, and also facilitating the distribution of *zakat* funds to the eligible beneficiaries. These digital platforms will also improve the outreach and impact of *zakat* funds, especially for tech-savvy *zakat* payers in the country. This is particularly true since most Kazakh people (77%) are active internet users, with this expected to surpass 82% of users by 2022.

(ii) Optimization of an online *zakat* platform

Apart from that, the current *zakat* ecosystem should be complemented by a centre for research and development of *zakat*. The research centre of *zakat* is expected to elucidate the fundamental and strategic issues about the latest developments in *zakat*/Islamic philanthropy in Kazakhstan. The centre could also assist the *zakat* institutions in developing a portal with an integrated *zakat* database that sets a *zakat* priority matrix for both *zakat* payers and beneficiaries, promote literacy and enhance efficiency.

(iii) Introducing a *zakat* performance indicator (such as integrating ISO certification)

With special reference to enhancing efficiency, it is also necessary to establish a *zakat* performance indicator. In this regard, ISO certification is required for the *zakat* institution, at least for the long term.

(iv) Ensuring greater Shari'ah governance and compliance by establishing a Shari'ah committee/appointing a Shari'ah advisor for *zakat* institutions

As *zakat* falls within the ambit of the Shari'ah, where the beneficiaries have been specifically outlined in the Quran, it is also essential to appoint a dedicated Shari'ah advisor to ensure that the administration, collection and distribution of *zakat* are in accordance with the Islamic legal principles. In this regard, the current practice of distribution of the bulk of *zakat* funds to mostly the religious leaders and mosques needs to be revisited. There is a need to broaden coverage of *zakat* to cover most, if not all, entitled beneficiaries.

9.3.4 STRATEGIC INITIATIVE 4 DEVELOP A ROBUST ZAKAT REGULATORY FRAMEWORK

(i) Facilitate the introduction of dedicated regulatory framework

There is a need to develop a dedicated *zakat* framework and regulation to chart the future direction of *zakat* system in Kazakhstan. The *zakat* framework should outline clear guidelines on the roles and functions of *zakat* authority, the obligation of *zakat* for Muslims and the proper mechanism of mobilisation and distribution. The legal and regulatory framework governing *zakat* should also promote

good governance and ensure greater transparency and accountability of the inflows and outflows of *zakat* funds. The information on its inflows and disbursement of *zakat* funds should be made public. This is to strengthen public trust to the *zakat* institutions and to accelerate the performance of *zakat* institutions in conducting their duties.

(ii) Treating *zakat* as an income tax rebate

The *zakat* framework should also consider tax benefits for *zakat* payers in accordance with international practices, such as tax deductions (adjustments) when calculating income tax to encourage *zakat* payment.

(iii) Adoption of international best practices i.e. *zakat* core principles and *zakat* criteria for performance excellence

The *zakat* authorities in Kazakhstan are also recommended to adopt international best practices, such as *ZakatCore Principles* and *ZakatCriteria for Performance Excellence*. It is anticipated that the adoption of international best practices of *zakat* will promote and upgrade the management and administration of the *zakat* institution in Kazakhstan.

9.3.5 STRATEGIC INITIATIVE 5 ENHANCE THE COMPETENCIES OF THE ZAKAT COLLECTOR ('AMIL)

(i) Setting a minimum qualification for 'amil, certified *zakat* collector programme

Competent personnel are required at all levels to ensure an effective functional structure. The current provision of minimum qualifications for 'amil, certified *zakat* collector should be revisited. The 'amil should be equipped with adequate information and education of factors involved in the system of *zakat* collection and distribution at all levels. This is to provide well-organized 'amil management and adequate problem-solving skills in *zakat* affairs.

(ii) Intensify training and education program for 'amil

The qualification of the 'amil may be enhanced through proper training and education that addresses the legal, Shari'ah, governance, and accounting aspects of *zakat*. For this purpose, the *zakat* institution could also establish cooperation with the universities and training institutes in Kazakhstan on human capital development for *zakat* collectors' qualification and competencies.

(iii) Actively engage and participate in international networks on *zakat*

The national *zakat* institution should also join international networks and events, such as the exchange program with other OIC countries and participation in the World *Zakat* Forum. The participation in the World *Zakat* Forum would export the 'amil to international best practices on *zakat* development, trends and common issues of *zakat* management across jurisdictions.

9.3.6 STRATEGIC INITIATIVE 6 INCREASE PUBLIC AWARENESS ON THE IMPORTANCE OF ZAKAT OBLIGATION

(i) Creation of a national campaign on increasing public understanding of *zakat*

Our FGDs have revealed that a misconception exists in Kazakhstan that *zakat* is only compulsory on the self-imposed *zakat* payable during the month of Ramadhan (*zakat fitr*). People also prefer to pay *zakat* directly to recipients they identify themselves. Therefore, it is essential to develop a detailed plan and

strategies to increase literacy on the *zakat* obligation on wealth and the importance of paying *zakat* through institutions. *Zakat* campaigns may also be intensified as national campaigns by leveraging on different platforms, such as social media, television, internet, and other channels. *Madaris* and mosques in Kazakhstan can also be used as the centre for *zakat* literacy and awareness where *zakat* is part of the national curriculum in Islamic schools and theme of *khutbah* in Friday prayers. The existing mosques and *madaris* in the country could play a substantial role in creating awareness and literacy on the obligation of *zakat*. Some countries appoint a well-known public figure as the *zakat* assignee to promote the *zakat* payment among millennials and the public at large. The same can also be considered in Kazakhstan.

The government should introduce a community-based *zakat* education program to enhance *zakat* literacy, especially for sub-urban and rural areas in Kazakhstan. This necessitates active participation and support from informal leaders in the community such as the imams and/or scholars.

WAQF

9.3.7 STRATEGIC INITIATIVE 1 FACILITATE THE OFFERING OF DIVERSE WAQF MODELS

(i) Establishing a national *waqf* body

Many people in Kazakhstan, due to their lack of understanding of the dynamic aspects of *waqf*, perceive *waqf* as associated mostly with immovable properties and lands for religious and educational purposes. As a result, the development of *waqf* largely concentrates on the building of religious and social infrastructure such as mosques, schools and orphanage centres. Therefore, it is recommended that a formal centralised national *waqf* body is instituted, to facilitate the development and promotion of diverse *waqf* models such as cash *waqf*, corporate *waqf*, *waqf* deposit, *waqf*-linked *Sukuk* and *waqf* unit trusts.

(ii) Introduce *waqf* institutions/centres in each region

The national *waqf* body should, in turn, establish *waqf* representative offices in each region within Kazakhstan and even the AIFC to achieve optimal collection of *waqf* and even participate via *waqf* funds (e.g. as an investing tool via a cash *waqf* fund). This representative office should be mandated to mobilise and manage different type of *waqfs*, both movable and immovable *waqf* assets. The representative office should also be authorised to channel *waqf* revenues to the relevant nominated beneficiaries. Almost similarly, *waqf* may function akin to a 'foundation' with the prudential and governance standards of a 'socially responsible corporation'.

9.3.8 STRATEGIC INITIATIVE 2 PROMOTE WAQF AS AN ENGINE OF ECONOMICS GROWTH

(i) Utilizing the *waqf* instrument as a government funding instrument

Waqf system has played a pivotal role in the advancement of socio-economic well-being of the Muslim community in the history of Islamic civilisation. Many phenomenal architectural relics and public infrastructure all over the world, from the Atlantic to the Pacific, throughout the centuries, were funded by *waqf*. In this regard, Kazakhstan can also consider *waqf* as a catalyst of economic growth. For this purpose, it is recommended that the *waqf* system be incorporated into one of the funding tools to support the government agenda for employment creation, poverty eradication, microfinance empowerment and infrastructure development. For example, the Ministry of Industry and Infrastructural Development can explore *waqf* concepts for tourism infrastructure as well as green and environmentally friendly projects.

9.3.9 STRATEGIC INITIATIVE 3 CREATE ENABLING AND CONDUCIVE REGULATORY ENVIRONMENT

(i) Introduce specific *waqf* legal framework

There is a need to develop a dedicated *waqf* framework and regulation to guide the direction of the *waqf* system in the country. The *waqf* regulation should outline the clear guidelines on the roles and responsibilities of the relevant parties in the *waqf* management. The framework should also facilitate the offering of diverse *waqf* models to maximise the potential of *waqf* assets. Also, the regulation is expected to offer incentives to the benefactors to encourage them participate in *waqf*.

(ii) Adoption of international best practices for *waqf* administration such as the *Waqf Core Principles*

It is also recommended that the *waqf* legislation take into account the adoption of International best practices, such as *Waqf Core Principles*, as to promote good governance, professionalism, transparency and greater accountability of *waqf* institutions.

9.3.10 STRATEGIC INITIATIVE 4 INCREASE THE LEVEL OF AWARENESS AND LITERACY ON WHY *WAQF* CAN SUPPLEMENT SOCIAL FINANCING

(i) Develop a framework for awareness programs leveraging on currently available infrastructures such as mosques and *madaris* as a centre for *waqf* literacy

As indicated earlier, there is a lack of literacy and understanding on Islamic social finance products in all segments of the population. The *waqf* institution also experiences lack of institutional trust from the public, resulting in inefficient mobilization of *waqf*. Instead of establishing a *waqf* fund to develop education, healthcare, infrastructure on a sustainable basis, rich Muslims in Kazakhstan prefer to give *sadaqah* to poor or needy people directly. Whilst this is virtuous and required, more funds are required for longer-term benefits.

In this regard, it is imperative to develop a plan and strategies to increase awareness and understanding on the role of *waqf* in social financing among all segments of society. As with *zakat*, national *waqf* campaigns may also be intensified. The awareness theme should place emphasis on the significance of *waqf* for the advancement of social economic well-being, the understanding that *waqf* is not only confined to immovable properties, and the advantages of participation in *waqf* through institutions. Mosques and *madaris* can also be used as the centre for *waqf* literacy where *zakat* can be part of the national curriculum in Islamic schools and theme of *khutbah* in Friday prayers. As in *zakat*, some countries appoint a well-known public personality as the *waqf* assignee to promote *waqf* among millennials and the public at large.

9.4 ACTION PLAN

ZAKAT

9.4.1 STRATEGIC INITIATIVE 1 ESTABLISH AND FACILITATE AN ENABLING ENVIRONMENT FOR A ZAKAT AND WAQF ECOSYSTEM

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to establish a national <i>zakat</i> centre under SAMK.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy
2.	Suggest to consider the creation of a <i>zakat</i> collection and distribution centre in each region.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy
3.	Suggest to appoint mosques as the <i>zakat</i> collection agents (<i>`ami</i>).						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, Mosques
4.	Suggest to develop a <i>zakat</i> database.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy
5.	Suggest to establish partnerships with government institutions and relevant stakeholders.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy
6.	Suggest to integrate <i>zakat</i> with the Islamic financial system.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance,

							Ministry of National Economy
7.	Suggest to consider partnership with financial institutions on <i>zakat</i> collection.						AIFC Authority SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
8.	Suggest to consider <i>zakat</i> deduction from saving accounts.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM, Banks
9.	Suggest to consider <i>zakat</i> payment option in CDS accounts.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM, KaSE, AIX

9.4.2 STRATEGIC INITIATIVE 2 PROMOTE *ZAKAT* TO SUPPORT SOCIAL PROTECTION SYSTEM AND FINANCIAL INCLUSION

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider <i>zakat</i> for government's financial aid program.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
2.	Suggest to consider <i>zakat</i> for child-sensitive protection system.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM

9.4.3 STRATEGIC INITIATIVE 3 DEVELOP ADEQUATE ZAKAT INFRASTRUCTURE

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to leverage financial technology in collection and distribution of <i>zakat</i> .						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
2.	Suggest to optimize online platform for <i>zakat</i> collection.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
3.	Suggest to establish a centre for <i>zakat</i> research and development.						AIFC Authority
4.	Suggest to establish <i>zakat</i> performance indicator – ISO certification.						AIFC Authority
5.	Suggest to appoint Shari’ah committee/advisor for <i>zakat</i> institutions.						AIFC Authority, SAMK, Ministry of Information and Social Development

9.4.4 STRATEGIC INITIATIVE 4 DEVELOP CONDUCIVE REGULATORY FRAMEWORK

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider a dedicated <i>zakat</i> regulatory framework.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
2.	Suggest to consider <i>zakat</i> as income tax rebate.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM

3.	Suggest to consider the adoption of international best practices, i.e. the 'Zakat Core Principles' and 'Zakat Criteria for Performance Excellence'.							AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
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9.4.5 STRATEGIC INITIATIVE 5 ENHANCE THE COMPETENCIES OF THE 'AMIL

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to set minimum qualification standards for 'amil.						AIFC Authority, SAMK, Ministry of Information and Social Development, Ministry of Finance, Ministry of National Economy, ARDFM
2.	Suggest to intensify training and education program for 'amil.						AIFC Authority, SAMK, Ministry of Information and Social Development
3.	Suggest to consider partnership with universities and training institutes on capacity building and training.						AIFC Authority, SAMK, Ministry of Information and Social Development, Universities
4.	Suggest to participate in exchange programs with other OIC countries.						AIFC Authority, SAMK, Ministry of Information and Social Development
5.	Suggest to participate in the World Zakat Forum and other relevant discourses on zakat.						AIFC Authority, SAMK, Ministry of Information and Social Development

9.4.6 STRATEGIC INITIATIVE 6 INCREASE PUBLIC AWARENESS ON THE IMPORTANCE OF ZAKAT OBLIGATION

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider mosques and <i>madaris</i> as the centre for <i>zakat</i> literacy.						AIFC Authority, SAMK, Ministry of Information and Social Development, Mosques

2.	Suggest to consider a social media campaign for <i>zakat</i> .						AIFC Authority, SAMK, Ministry of Information and Social Development
3.	Suggest to consider <i>zakat</i> advertisements in newspapers, magazines, and billboards.						AIFC Authority SAMK, Ministry of Information and Social Development
4.	Suggest to increase awareness of <i>zakat</i> obligation on wealth (<i>zakat maal</i>).						AIFC Authority, SAMK, Ministry of Information and Social Development, Mosques
5.	Suggest to promote payment of <i>zakat</i> through institutions.						AIFC Authority, SAMK, Ministry of Information and Social Development, Industry players

WAQF

9.4.7 STRATEGIC INITIATIVE 1 FACILITATE THE OFFERING OF DIVERSE WAQF MODELS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Establish national <i>waqf</i> body.						AIFC Authority
2.	Introduce <i>waqf</i> institution / centre in each region.						AIFC Authority
3.	Development and promotion of diverse <i>waqf</i> model.						AIFC Authority

9.4.8 STRATEGIC INITIATIVE 2 PROMOTE WAQF AS AN ENGINE OF ECONOMIC GROWTH

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest utilizing the <i>waqf</i> instrument as a government funding instrument.						AIFC Authority, ARDFM, NBK, AFSA

9.4.9 STRATEGIC INITIATIVE 3 CREATE ENABLING AND CONDUCIVE REGULATORY ENVIRONMENT

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Introduce a specific <i>waqf</i> legal framework.						AIFC Authority, AFSA
2.	Adoption of international best practices, i.e. The <i>Waqf</i> Core Principles.						AIFC Authority

9.4.10 STRATEGIC INITIATIVE 4 INCREASE THE LEVEL OF AWARENESS AND LITERACY ON WHY *WAQF* CAN SUPPLEMENT SOCIAL FINANCING

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Intensify <i>waqf</i> campaign.						AIFC Authority, SAMK
2.	Suggest to consider mosques and <i>madaris</i> as the centre for <i>waqf</i> literacy.						AIFC Authority, SAMK, Mosques

CHAPTER 10: FINANCIAL TECHNOLOGY (FINTECH)

10.1 INTRODUCTION

FinTech is often referred to as an innovation in technology in the design and delivery of financial services in order to reduce cost, enhance efficiency and promote financial inclusion. Such end-to-end processes may enable a financial ecosystem to be replaced or enhanced in progressive or disruptive ways. This includes financial product administration, vetting, marketing, distribution and supervision. The use of technology in financial services is closely correlated with the pace of evolution in the technology industry. The emergence of blockchain and exponential advances in data transfer rates have poised almost all sectors of industry for a significant transformation.

Technically, FinTech include big data analysis, Internet of Things (IoT), mobile Apps, algorithms, block-chain, Artificial Intelligence (AI) amongst existing developments awaiting release. Broadly, FinTech services may be categorised into 5 key areas:

- i. Finance and investment;
- ii. Operations and risk management;
- iii. Payments and infrastructure;
- iv. Data security; and
- v. Customer interface.

FinTech solutions designed for the market have focused on 5 broad segments that have gained significant market penetration as stand-alone solutions:

- i. Banking and lending (eg. Ant Financial, Softbank);
- ii. Payment and fund transfers (eg. PayPal);
- iii. Investment and wealth management (eg Coffee Cup);
- iv. Insurance (eg. Lemonade insurance); and
- v. Regulation (eg. Abide Financial, Kaizen Reporting).

10.1.1 CURRENT LANDSCAPE OF FINTECH IN KAZAKHSTAN

According to the World Economic Forum's ("WEF") Global Technology Report, Kazakhstan holds 39th place in the global Networked Readiness Index (NRI), which measures the propensity of the economy to employ information and communication technology ("ICT"). WEF notes high affordability and government usage of digital technologies in Kazakhstan. Quantitative indicators of development of the ICT industry, such as number of telephone lines or mobile users, reached average or above-average global levels⁴⁹.

⁴⁹ "Telecommunications Industry – Transformation of the industry", *The Research and Knowledge Management Department Strategy and Portfolio Investment Block of JSC Samruk-Kazyna*, 7 November, 2016.

Key indicators for Kazakhstan (2017)		CIS	World
Fixed-telephone sub. per 100 inhab.	20.3	19.8	13.0
Mobile-cellular sub. per 100 inhab	145.4	138.3	103.6
Active mobile-broadband sub. per 100 inhab.	75.1	72.0	61.9
3G coverage (% of population)	87.3	80.3	87.9
LTE/WiMAX coverage (% of population)	72.5	61.1	76.3
Individuals using the Internet (%)	76.4	68.6	48.6
Households with a computer (%)	76.2	68.1	47.1
Households with Internet access (%)	84.9	73.6	54.7
International bandwidth per Internet user (kb/s)	69.8	66.8	76.6
Fixed-broadband sub. per 100 inhab.	14.1	17.8	13.6
Fixed-broadband sub. by speed tiers, % distribution			
-256 kbit/s to 2 Mbit/s	5.8	12.2	4.2
-2 to 10 Mbit/s	37.6	25.1	13.2
-equal to or above 10 Mbit/s	56.6	62.7	82.6

Source: *Measuring the Information Society Report Volume 2, 2018, ITU Publications*

In March 2018, the NBK launched the Invest Online real-time service for investing in the notes issued by the NBK and trading in securities of major Kazakhstan companies. The Invest Online service uses such innovation solutions as blockchain and electronic money issued by the NBK as a payment means for securities transactions. User can track the income accrual via their personal accounts on the system. This can be accomplished after downloading the mobile application.

The NBK has also designed an instant mobile payment system. The system allows for money payments and transfer based on the mobile phone number. This system is expected to support the NBK initiatives on anti-money laundering by increasing the share of a cashless society in Kazakhstan.

The leading sectors in FinTech with the highest market potential in Kazakhstan have been identified as follows:

Supply Side	Demand Side
<p>Digital banks</p> <ul style="list-style-type: none"> ▪ Banking products ▪ Machine learning ▪ Artificial Intelligence <p>Scoring</p> <ul style="list-style-type: none"> ▪ Client data analysis ▪ Cloud Technology ▪ SaaS ▪ Application Programming Interface (“API”) <p>Lending</p> <ul style="list-style-type: none"> ▪ Online lending ▪ Blockchain ▪ Big data ▪ POS lending in real time ▪ Biometric analysis 	<p>Retail Segment</p> <ul style="list-style-type: none"> ▪ Online payment service ▪ Cashback service ▪ Real time POS lending ▪ mPOS <p>Microfinance organizations</p> <ul style="list-style-type: none"> ▪ Business process automation ▪ Client data analysis ▪ P2P lending ▪ Real time POS lending

Source: *Private FinTech as a tool for sustainable business development in Russia and Kazakhstan, by Deloitte CIS Research Center, 2018*

10.1.2 STRATEGIC OBJECTIVES

The AIFC FinTech Hub creates favorable conditions through premium infrastructure for the development of the financial technologies market. It established an objective to unite all regional participants of the financial technologies market to implement and stimulate new products, create a single market for financial technology providers, increase the level of human capital and know-how, and develop entrepreneurial thinking within the population⁵⁰. The AIFC FinTech Hub is an official participant of the Global FinTech Hub Federation (GFHF).

AIFC FinTech Hub launched the largest regional programme for the development of FinTech innovations in Kazakhstan and Central Asia – Visa Everywhere Initiative in March 2019. It has since signed more than 100 agreements on partnership and cooperation in various directions with the world's largest corporations, including those from the area of FinTech.

10.1.3 THE ROLE OF AIFC'S FINTECH HUB

- i. To focus on public FinTech literacy;
- ii. To conduct the startup support programs;
- iii. To consolidate the efforts of business representatives to introduce innovations in the financial sector;
- iv. To attract investors and business angels to invest in the FinTech and Tech industry in Kazakhstan;
- v. To exchange knowledge, experience and to attract young specialists to the FinTech industry;
- vi. To co-operate with financial and non-financial institutions, FinTech startups, regulators, associations, conferences and universities;
- vii. To provide mentoring, training, consulting and networking;
- viii. To co-operate with investment funds and private investors;
- ix. To support projects for fundraising; and
- x. To support the development and coordination of new legislative.

10.1.4 ECOSYSTEM CAPABILITIES ASSESSMENT

Strengths	Weaknesses
<ul style="list-style-type: none">▪ AIFC FinTech Hub provides favorable financial and non-financial conditions for FinTech companies to start up;▪ Transparent and independent legal system;▪ One-stop registration through AIFC;▪ Government supporting laws regulating the venture and online lending market;▪ Mobile internet usage 77%; and▪ Favorable immigration and individual income tax regime for foreign tax employees.	<ul style="list-style-type: none">▪ Shortcomings of government regulation of the industry;▪ Insufficient protection of personal data;▪ Low appeal of Kazakhstan's FinTech VC industry for foreign investors;▪ Limited talent pool in FinTech; and▪ The venture finance market is not sufficiently developed.

⁵⁰ "The Financial Hub of the Region", *AIFC Finance Days*, AIFC, 5 July, 2018.

Opportunities	Threats
<ul style="list-style-type: none"> ▪ Untapped potential growth in finance related products; ▪ Partnerships with local SOEs utility company, such as telecommunication and post office; ▪ Fast growing and liberalization of CIS regions; and ▪ Positioning AIFC as an Internationally vibrant marketplace for payment gateway. 	<ul style="list-style-type: none"> ▪ Cyber threats; ▪ Currency volatility risks; ▪ Limited local market shares; and ▪ Competition from the regions on the FinTech industry.

10.2 ISSUES AND CHALLENGES

In Kazakhstan, financial inclusion is relatively low. Major challenges in financial inclusions are primarily due to the mismatch of the costs and benefits offered by the financial industry and the vast demography of the country.

Generally, established financial institutions tend to hold the 'wait-and-see' approach on any technological advancement. This is expected since financial institutions focus their relationships and business on wholesale customers which makes up the largest customer segment who mainly rely on traditional financial services.

The wholesale market has dominated the financial services industry, of which 92% of the SMEs maintain an account with financial institutions. Only 59% of individuals maintain an account with financial institutions with those using debt remaining below 10% of GDP, indicating untapped potential for economic growth⁵¹.

Financial institutions are concentrated in urban areas resulting in a significant proportion of the population being excluded. It may be costly for the financial institutions to operate in the rural areas as there is a lack of 'banked' customers, higher costs related to customer's credit assessment and documentation, geographical disparity, information asymmetry, security and storage maintenance and infrastructure barriers.

On the regulatory side, limitations of foreign ownership in financial institutions, restriction on foreign bank operations, constraints in branch operations, limitation on customers and transactions, capital adequacy requirements and supervisory rules all entail a higher cost for the financial institution to capture the individuals' market in the rural areas. Furthermore, the talent pool and expertise in FinTech and Islamic finance are negligible at policy, regulatory and industry levels.

The underserved market for the individuals' market segment is largely unreported and they form the potential for a large customer base for financial institutions.

Lack of awareness and understanding on FinTech and Islamic finance, lack of funds and disposable income, the trust deficit towards the financial system and currency accessibility cause banked individuals to continue to remain largely financially excluded through limited use of financing. Hence, the effective adoption of FinTech solutions are expected to alleviate these limitations and develop the market more efficiently.

10.3 RECOMMENDATIONS

A holistic and effective adoption of FinTech requires the government to collaborate with the market players to develop innovative processes and delivery systems to the end users. It is the AIFC FinTech Hub's responsibility to encourage innovation by providing a direction, guidance and initiative to the financial institutions and FinTech companies without compromising on the desired outcome. This can be achieved by a successfully implementation of the following strategic initiatives:

⁵¹ Kapparov, Kassymkhan, "Financial Inclusion and Financial Literacy in Kazakhstan", *Asian Development Bank Institute*, October, 2018.

- i. Strengthening financial stability and sustainability through the integration of financial institutions and FinTech companies' participations;
- ii. Enhancing the fairness, soundness and safety of its financial system;
- iii. Preserving the confidentiality and protection of customers data; and
- iv. Increasing financial inclusion through efficient, cost effective and innovative financial gateways.

FinTech also serves as an enabler of cost effectiveness on financial transactions, improvement of product qualities and increasing economic activities by mobilizing the financial resources of the nation. This enabler may have a significant positive impact on financial inclusion in the retail market segment through introduction of innovative financial services and products that meet the needs of the underserved market segment.

Through FinTech innovation, AIFC FinTech Hub may strengthen the financial stability and sustainability by reaching out to the underserved segment and transforming the national financial system into a largely cashless society.

FinTech enables technology innovation to target the underserved market. Traditional financial institutions which fail to integrate FinTech into their daily business may be facing the risk of losing market share to their competitors (which may also be non-financial institutions).

10.3.1 STRATEGIC INITIATIVE 1 STRENGTHENING FINANCIAL TECHNOLOGY STABILITY AND SUSTAINABILITY

(i) Joint collaboration between existing Fintech Hub initiatives across Kazakhstan and the AIFC

To strengthen the financial stability and sustainability of the various digital technological infrastructures across Kazakhstan (including the AIFC), it is imperative to foster a much closer collaboration between the existing FinTech hubs and the AIFC. This is to ensure standardization of the form of national FinTech policies will be implemented across the country which involve the spheres of both the AIFC and the ARDFM in terms of policy development. The NBK (and/or ARDFM) and AIFC FinTech Hub shall jointly introduce rules for e-transactions and the standard operating procedures on supervisory review on financial technology service providers.

(ii) Extending the digital infrastructure to operate on a wider basis

Financial innovation and technological advances have spawned a stunning range of products that are now operated, and dealings transacted through networks of multi-functional platforms so much so that a single electronic device such as a smartphone may perform all such actions of matching transactions through multiple venues. These new functionalities have brought about new parameters of the financial sector and are transforming the rules of traditional intermediation between financial service providers and end users.

These developments must be integrated by the AIFC and Kazakhstan, extending any existing or future banking API with the capital markets to foster more digital-based transactions among the economy of Kazakhstan and to the AIFC. This may also make the AIFC as a digital bridge should the AIFC's API is then developed further to link with the APIs of other international financial centres and make the AIFC the gateway of digital economy within the region. The AIFC shall move to facilitate access to credit reports by financial service providers and possibly enable higher transaction limits on e-transactions between the AIFC and Kazakhstan. Moving towards a more collaborative and wider FinTech use will also help to promote more efficient and responsible credit and repayment culture.

This integration will lay down the foundation for future programs for Kazakhstan to cope with and promote initiatives to enter a future of increasingly cashless transactions. Moving forwards, this may perhaps give the AIFC the opportunity to position itself as the nexus of financial data for the region. As

a leader in electronic financial infrastructure, this will only serve to strengthen the AIFC as the regional hub of Central Asia.

10.3.2 STRATEGIC INITIATIVE 2 ENHANCING THE FAIRNESS, SOUNDNESS AND SAFETY OF ITS FINANCIAL TECHNOLOGICAL SYSTEM

(i) Integration of RegTech with FinTech

In line with the increasing the capacity and capability of the relevant regulatory authorities, the AIFC and ARDFM can enhance the financial service value-chain by integrating FinTech along with RegTech so as to prevent any double processing from happening within the value-chain, enable real-time monitoring and to bring out any shadow banking activities.

10.3.3 STRATEGIC INITIATIVE 3 INCREASING FINANCIAL INCLUSION THROUGH EFFICIENT, COST EFFECTIVE AND INNOVATIVE FINANCIAL GATEWAY

(i) Introducing of a new FinTech framework which integrates Islamic finance

FinTech is an increasingly vital and a game-changer in the provision of financial inclusion throughout the nation and the region. Considering the changing dynamics of innovation, the AIFC should consider taking the mantle of leadership and set up a clear vision on the direction of FinTech development for both the AIFC and Kazakhstan. The AIFC and Kazakhstan shall prepare a digital framework or blueprint which also integrates Islamic virtual banking which will allow Islamic finance service providers to offer fully digitalized financial services and cut down on any physical costs.

This can be done via a smaller scale if the AIFC start with a smaller set-up such as by allowing fully-digital Islamic microfinancing licenses or allowing fully digital microfinancing platforms to be hosted in the AIFC.

Financial providers shall enhance financial services and product qualities offering made online. Likewise, the regulators shall develop financial service provider framework to enable cost effectiveness and efficiency on such transactions in line with the vision and strategic pillars as set out in the blueprint.

(ii) Expanding FinTech application to other forms of innovative Islamic finance elements

Fintech offerings in the AIFC and Kazakhstan should be broadened to allow Islamic P2P platforms to exist and grow within the AIFC which will serve the whole of Kazakhstan region. Taking for example from Malaysia, P2P licenses are strictly limited to ensure that only truly capable institutions are able to host them, however, expansion plans are in the works. By allowing fully-digital P2P or microfinancing platforms, the retail segment of the region can be exposed to small scale investing wherever they are thus allowing for a broad outreach to even rural areas in the effort of financial inclusion.

These efforts should then be further expanded upon by the AIFC or Kazakhstan to host a digital *zakat* platform as an effort to incentivize *zakat* payments amongst businesses by making *zakat* collection easy and transparent. This can also give the SAMK a more centralized monitoring and collection service.

As with the allowing of the hosting of a digital *zakat* platform, the AIFC shall also look into the broadening of the digital platform to allow the hosting or listing of *waqffunds* and institutions onto a single AIFC *waqf* platform. This will continually be monitored by the registration regime of the AIFC and AFSA to ensure that the listed funds or *waqfare* genuine and is run with the highest governance standards available. This effort can be an expansion of the initial digital *zakat* platform as awareness becomes more widespread on the availability of the platform. This digital platform may also act as a very important to link and

connect the corporate social responsibility (CSR) efforts with genuine segments of the Kazakh populace that is in need of the social capital

(iii) Enhancing connectivity and access of FinTech to outlying areas

To ensure that the far-reaching capabilities of FinTech achieves the aim of financial inclusion, any FinTech framework must take into account the adoption of mobile apps for financial transactions. Kazakhstan should take advantage of its very high rate of mobile penetration among its population. The strategy behind mobile financial services must be enabled and simplified through the simplification of multi levels of financial services which covers bank and non-bank activities, and these can be achieved in the most basic of forms such as fiat money payment via digital payment method. These transactions may cover from institutions to the individual level and from capital market to financial industry.

As the digital infrastructure of Kazakhstan network service continue to be developed, the financial services should be encouraged to enhance the connectivity and access to financial services of the outlying areas through increase technology adoption and technological literacy. The AIFC shall also incentivize financial service providers to educate and promote financial technology literacy among the public as part of their marketing and business development plan. The AIFC shall look into the conversion of traditional financial services into digital financial services implementing plans to allow for virtual Islamic banking or virtual *takaful*.

10.3.4 STRATEGIC INITIATIVE 4 PROMOTE COLLABORATION WITH INTERNATIONAL PARTICIPANTS

(i) Increasing regional digital collaboration

The AIFC benefits from the inclusion of Kazakhstan as a member of the EAEU Digital Union, in line with the movement of the global trend, both the AIFC and Kazakhstan can increase collaboration efforts among the EAEU Digital Union member states by suggesting of a common digital currency to be used as a trade token backed by a common asset or a common digital transaction platform. The AIFC should champion more seamless regional trade and transaction while removing the need for constant currency hedge.

(ii) AIFC as a digital intermediary

Both the AIFC and Kazakhstan can increase collaboration by integrating and expanding its digital framework to accommodate the One Belt One Road Initiative by positioning itself as a digital processing hub for all the transcontinental goods that moves through Kazakhstan. In line with its vision and mission to be the regional hub for Islamic finance, the AIFC can also position itself as a regional digital hub that facilitate trade between its regional neighbors.

(iii) Utilising FinTech as a means of tourism development

To support the National Tourism Development Program, Kazakhstan should implement as part of its policy of opening up to the free movement of people a framework to support the increasing use of e-wallets by foreign travelers. This more open policy makes visiting and spending in Kazakhstan a more seamless experience while allow for a deepening in the technological exposure throughout Kazakhstan.

10.4 ACTION PLAN

10.4.1 STRATEGIC INITIATIVE 1 STRENGTHENING FINANCIAL STABILITY AND SUSTAINABILITY

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider to foster the collaboration between NBK and the AIFC.						AIFC Authority, NBK
2.	Introduce rules for financial technology service providers for e-transactions.						AIFC Authority, AFSA
3.	Introduce supervisory review framework on financial technology service providers.						AIFC Authority, AFSA

10.4.2 STRATEGIC INITIATIVE 2 ENHANCE FAIRNESS, SOUNDNESS AND FINANCIAL SYSTEM SAFETY

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Integrate RegTech with current FinTech system.						AIFC Authority, ARDFM, AFSA

10.4.4 STRATEGIC INITIATIVE 4 INCREASING FINANCIAL INCLUSION THROUGH EFFICIENT, COST EFFECTIVE AND INNOVATIVE FINANCIAL GATEWAY

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Develop financial service provider framework integrating Islamic finance.						AIFC Authority, NBK, ARDFM, AFSA
2.	Increase adoption of mobile apps for financial transactions.						AIFC Authority, Industry players
3.	Incentivize financial service providers to educate and promote financial technology literacy.						AIFC Authority, NBK

4.	Develop a framework for virtual Islamic banking.						AIFC Authority, AFSA
5.	Develop a framework for virtual Islamic microfinancing.						AIFC Authority, AFSA
6.	Develop a framework and introduce a licensing regime for Islamic P2P financing.						AIFC Authority, AFSA
7.	Develop a framework for digital <i>zakat</i> and <i>waqf</i> platforms.						AIFC Authority, AFSA

10.4.5 STRATEGIC INITIATIVE 5 PROMOTE COLLABORATION WITH INTERNATIONAL PARTICIPANTS

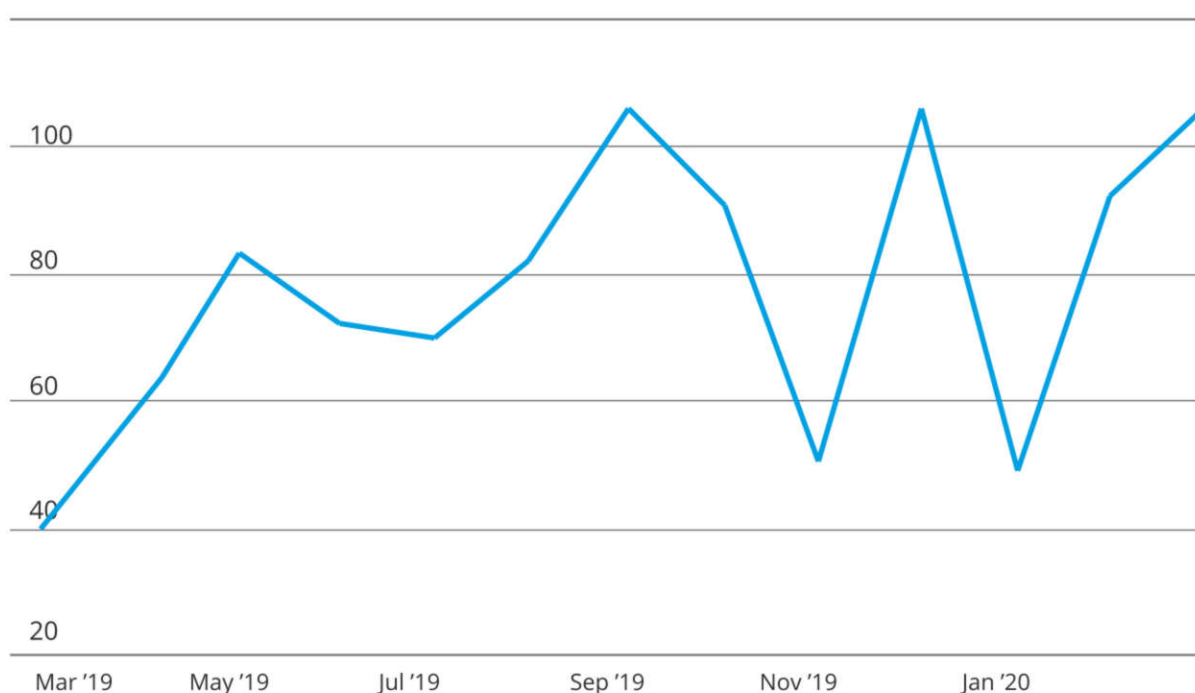
No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Participate or enhance participation with the EAEU Digital Union (integration on digital currency for trade).						AIFC Authority, NBK
2.	Integrate digital wallet system with the National Tourism Development Program.						NBK, AIFC Authority, Ministry of Culture and Sports

11.1 INTRODUCTION

The International Monetary Fund reported that after a strong growth in 2017 and early 2018, global economic activity slowed notably in the second half of 2018 reflecting a confluence of factors affecting major economies. Global economic growth was projected to slow from 3.6% in 2018 to 3.3 % in 2019. Precarious (trade balance) recovery efforts must be undertaken by the government to anticipate and mitigate risk that might cause any financial shock or crisis.

In addition, the uncertainty of global economy continued into 2019. As a result, many developing countries would be impacted significantly, especially countries which have a strong reliance on the USA economy. This uncertainty can be described in the following diagram as such:

ECONOMIC POLICY UNCERTAINTY INDEX



Source: Available at <https://www.policyuncertainty.com/>

The above describes the global economic uncertainty and the reactionary USA trade policy moving in parallel which indicates there is a possibility of an increase in uncertainty in the period to come. External shocks remain a core challenge for Kazakhstan in achieving economic stability and sustainable development. This may be inferred from the ongoing political-economic tension between the USA against China and Russia, both being the main trading partners of Kazakhstan and global players in the oil-and gas market. A downward trajectory in the economy of these countries will affect the oil and gas exports that Kazakhstan provides and in return affect the Kazakhstan national economy. Therefore, Kazakhstan's position in an unenviable position as it needs to carefully leverage the global economic uncertainty and the economic outlook of its neighbours. The government of Kazakhstan however has been proactive in this respect and while certain issues remain, there have been multiple attempted actions to safeguard and diversify its economy.

Kazakhstan's economy in 2018 recorded a respectable growth rate of 4.1 % supported by higher oil exports and strong domestic consumption. Its current economic indicators are as per below:

No	Indicator	Value
1	Population	18.8 million
2	GDP	168.5
3	GDP per capita	11.16
4	Life expectancy	73.9

Source: World Bank Country Report 2019

The term “*halal*” describes the permissibility of goods and services for the consumption and trade as defined by the Shari’ah. It covers not only food and beverages, but also fashion, recreation, medicine and specific media products. The *halal* industry has become an important business segment due to the growing Muslim population, rising incomes and increasing awareness about the tenets of their religion. *Halal* certification is often perceived by both Muslims and non-Muslims, as a stamp of approval guaranteeing the quality and safety of food. For being a most promising business, the global *halal* industry has attracted a larger universe of companies than any other sector of the global Islamic economy.

According to the State of the Global Islamic Economy Report 2018/19⁵², it is estimated that Muslim consumers have spent US\$2.1 trillion for food, beverages and lifestyle products in the year 2017, and forecasted to cross the mark of US\$3 trillion by 2023. For the food and beverage, in 2017, Muslims spent US\$1.3 trillion, followed by modest fashion (US\$270 billion), media and recreation (US\$209 billion), travel (US\$177 billion), pharmaceuticals (US\$87 billion) and cosmetics (US\$61 billion).

Throughout the period of 2017-2019, Kazakhstan has demonstrated increasing interest in the domestic *halal* sector and is looking to expand it to cater to the global market and boost its national economy, in particular in *halal* cosmetics and halal meats. *Halal* cosmetics products are now present in major cities across Kazakhstan such as Almaty, Nur-Sultan, Shymkent and Uralsk. Kazakhstan’s *halal* meat produce has also entered into the UAE and Middle East market and has prompted a request from these markets for more Kazakhstan *halal* certified meats⁵³.

Kazakhstan’s *halal* meat has already entered into the Middle Eastern markets and has prompted a request from these markets to increase the supply of Kazakhstan *halal* certified meats. There are certainly opportunities available to Kazakhstan to participate in this growing global sector. The number of outlets selling *halal* food has risen in recent years alongside an increase in the number of *halal* enterprises operating in Kazakhstan. In 2002, there were an estimated mere 8 *halal* specialists in the country. Now, Kazakhstan is home to over 600 *halal* businesses and 130 dedicated slaughterhouses catering to Kazakhstan’s Muslim population. Especially in the meat sector, *halal* food has become a driving force in Kazakhstan’s food and beverage market with roughly 30% of all meat sold throughout the country is classified as *halal*⁵⁴.

There are certainly opportunities available for Kazakhstan to become a part of a growing sector which caters to a demand beyond the current global Muslim population (approximately 1.8 billion and growing). Even the food and beverages *halal* sub-sector alone is globally estimated to amount up to US\$1.303 trillion in 2017 according to the State of the Global Islamic Economy Report 2018/2019 of Thomson Reuters⁵⁵. Kazakhstan and the AIFC as its enabler also stand poised to cater to in the immediate term, to the needs of the approximately 100 million strong Muslim population of the CIS region.

⁵² “State of the Global Islamic Economy Report 2018/19: Islamic Economy Marks Steady Growth”. Thomson Reuters & Dinar Standard, 2018. Available at: <https://tinyurl.com/halalsector>

⁵³ Y. Uatkhonov, “Arab businesses urge production of halal-certified meats in Kazakhstan”, *The Astana Times*, 26 May, 2017. Retrieved from: <https://astanatimes.com/2017/05/arab-businesses-urge-production-of-halal-certified-meats-in-kazakhstan/>

⁵⁴ “Kazakhstan’s \$3 billion halal food sector”, *ITE Food & Drink*, 2017, April 2018. retrieved from: [http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-\\$3-billion-halal-food-sector](http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-$3-billion-halal-food-sector)

⁵⁵ “State of Global Islamic Economy Report 2018/19: An Inclusive Ethical Economy”, Thomson Reuters, 2019. Retrieved from <https://haladinar.io/hdn/doc/report2018.pdf>

In Kazakhstan now, approximately US\$3 billion out of the total US\$22 billion spent on food and drink across the country every year is spent on *halal* foodstuffs. The number of outlets selling *halal* food has risen in recent years alongside an increase in the number of *halal* enterprises. In 2002, there were a mere 8 *halal* businesses in the country; now, Kazakhstan is home to over 600 *halal* businesses and 130 dedicated slaughterhouses catering to its Muslim population. The meat sector has become a driving force in Kazakhstan's *halal* market growth capturing roughly 30% of the meat market⁵⁶. Kazakhstan has actively organized World Food Kazakhstan which involved *halal* sector as the government's concern. The main products during this event mostly for food and drinks products.

Given the positive reception, the *halal* sector remains to be a promising area for the diversification of Kazakhstan's economy and a channel for the development of Islamic finance from the AIFC or mainland Kazakhstan. Growth in the *halal* sector would contribute positively to Kazakhstan's balance of trade given its strategic location and proximity with other Muslim-majority nations. Some international *halal* producers have also indicated interest to set up manufacturing sites in Kazakhstan. Malaysia-based Mardi Holdings Sdn Bhd is an example of a foreign entity which has initiated efforts to develop investments in a range of *halal* production facilities in Kazakhstan due to Kazakhstan's potential as an exporter of *halal* product⁵⁷.

Another potential growth area for Kazakhstan within the *halal* sector *halal* travel destinations. The Muslim travel market is on course to reach US\$220 billion by 2020 and is expected to reach US\$300 billion by 2026. Situated at the very heart of the Eurasian region and at the second crossroads between the largest countries of Asia and Europe, Kazakhstan, with its unique nature reserves, national parks, archaeological and historical monuments possess the unique potential to be not just be a tourism connection point, but also a full-fledged tourism destination on its own⁵⁸. Kazakhstan's effort in creating more connectivity such as the lifting of visa requirements up to 30 days for nationals of 45 countries including Malaysia since 1st January 2017 is a positive step to promote tourism in Kazakhstan⁵⁹.

Unfortunately, according to the annual Mastercard-Crescent Rating Global Muslim Travel Index for the period of 2017-2019, Kazakhstan's ranking and score showed a downward trend compared to its peers in the Central Asian region⁶⁰.

The same report showed that in terms of performance, Kazakhstan scored very well in the categories of safety and culture (94), restaurants (81) and prayer places (90) but very poorly in unique experience (18), ease of communication (13), digital presence (16), outreach (28) and air connectivity (27). Kazakhstan's efforts in creating more connectivity such as the lifting of visa requirements showcase a positive step to promote tourism in Kazakhstan and this showed with its increasing visa score of (76) in 2019 from (68) in 2018⁶¹.

11.2 ISSUES AND CHALLENGES

11.2.1 LACK OF INTEGRATION OF ISLAMIC FINANCE AND THE HALAL SECTOR

An integrated *halal* ecosystem is a pre-requisite for a truly vibrant *halal* sector and includes Islamic financing as a part of the economic chain from inception right up to distribution of *halal* products to consumers. The *halal* sector in Kazakhstan should also implement good management standards, proper systems and well-established standard operating procedures. However currently, Kazakhstan lacks the necessary tools to

⁵⁶ "Kazakhstan's \$3 billion halal food sector", *ITE Food & Drink*, 18 April, 2017. Retrieved from: [http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-\\$3-billion-halal-food-sector](http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-$3-billion-halal-food-sector)

⁵⁷ *ibid*

⁵⁸ A. Yusoff, "Kazakhstan wants to tap Malaysia's Halal expertise". *The New Straits Times*, 5 March, 2019. Retrieved from <https://www.nst.com.my/business/2019/03/466184/kazakhstan-wants-tap-malaysias-halal-expertise>

⁵⁹ <https://www.nst.com.my/business/2019/03/466184/kazakhstan-wants-tap-malaysias-halal-expertise>

⁶⁰ Kazakhstan's rank between 2017 to 2019 was (17), (20) and (24) respectively. In comparison, Kyrgyzstan saw its rank improve from (30) in 2018 to (29) in 2019, Turkmenistan improved from rank (71) in 2017 to (51) in 2019 while Uzbekistan saw its rank improve from (32) in 2018 to (22) in 2019, surpassing Kazakhstan for the first time ever. MasterCard, CrescentRating (2017, 2018 & 2019). *Global Muslim Travel Index 2017, 2018, 2019*.

Retrieved from <https://www.crescentrating.com/reports/mastercard-crescentrating-global-muslim-travel-index-gmti-2017.html>;

<https://www.crescentrating.com/reports/mastercard-crescentrating-global-muslim-travel-index-gmti-2018.html> &

<https://www.crescentrating.com/reports/global-muslim-travel-index-2019.html>

⁶¹ A. Yusoff, "Kazakhstan wants to tap Malaysia's Halal expertise", *The New Straits Times*, 5 March, 2019. Retrieved from <https://www.nst.com.my/business/2019/03/466184/kazakhstan-wants-tap-malaysias-halal-expertise>

develop and connect existing *halal* players with these soft-infrastructures and lacks policy, supervision and regulation to guide it. The SAMK in an FGD conducted stated that the current *halal* industry is unorganised and lacks a definitive focus.

This lack of supporting infrastructure hampers the growth of *halal* players within the Kazakhstan market especially when *halal* businesses wish to ensure that their entire value chain and going concern of the business is Shari'ah compliant. The SAMK also viewed that the lack of integrated standards resulted in a suspicion with regards to the assurance of *halal*-ness in the market compounded with instances of contamination between *halal* and non-*halal* produce. An appropriate framework as a guidance not just for the market players but also the policy making body is needed to ensure that the *halal* sector can grow and contribute significantly to the national economy.

11.2.2 DISJOINTED HALAL MANAGEMENT SYSTEM

In terms of *halal* certification and supervision in Kazakhstan, the *halal* sector is serviced by private certification institutions such as the SAMK, *Halal* Quality Centre ("HQC") and the Association of *Halal* Industry Kazakhstan ("AHIK"). Ultimately, *halal* certification is left entirely to the market without government intervention. The SAMK (also commonly known as "the Muftiyat") is an entirely independent body not under the government of Kazakhstan and is not funded by the government. As such in Kazakhstan, the *halal* certification process is entirely reliant upon the standards of these three bodies and funding are primarily via the payments received from corporations interested to be *halal* certified. Nevertheless, the SAMK indicated that in November 2019, the SAMK will attempt to work with the HQC and AHIK to introduce a national *halal* certification standard to centralize if not, create a systematic minimum standard to *halal* management and certification systems.

11.2.3 LACK OF APPRECIATION FOR HALAL CERTIFICATION AND MANAGEMENT SYSTEM

In general, from our fact-finding missions, the Kazakhstan society's familiarity with *halal* is mainly in relation to food and drinks. There persists only a basic understanding on the breadth of the *halal* sector and there is a lack of a concerted effort to increase awareness and literacy about a wider range of *halal* products and industry itself.

Halal entities themselves in this regard have attempted to enhance awareness levels but with limited success. It is important that certification for products other than food and drinks be facilitated in collaboration with relevant stake holders as Kazakhstan do possess the potential to grow its prospects in *halal* travel or tourism, pharmaceutical products and cosmetics. Various small-scale efforts must be supported to give it the room to reach the critical mass necessary to realise the Kazakhstan national vision of diversification in industry and creation of new areas for economic growth.

In order to preserve the quality of *halal* certification for products other than food and drinks, the relevant stakeholder may seek assistance from external experts to develop appropriate methodologies, processes and procedures. Collaborations in this manner gives exposure and presents new opportunities for not only cross-cultural exchanges in terms of skill but also the reciprocal opening up of markets between Kazakhstan and other *halal* markets.

11.2.4 PUBLIC ACCESS TO HALAL ASSURANCE

Public access to *halal* assurance has a vital role to ensure public comfort and confidence in consuming goods and utilizing services that comply with Shari'ah principles. However, there is currently little in terms of a public database whether via online or otherwise mobile platforms or applications that can be easily accessed by the public or visitors if they would like to access information about *halal* operators. This is a key gap in the development of *halal* industry in Kazakhstan compared to other more mature markets such as Malaysia or Indonesia.

In the midst of global competition, it is a necessity for the *halal* industry to adopt the most recent advanced technologies to develop and build competitiveness. However, there are currently no digital strategy to improve public access to *halal* products and services in Kazakhstan. With greater collaboration between the government and the industry public awareness, access to halal assurance would create a positive impact on the national *halal* industry and strengthen the *halal* value chain, medium and micro enterprises and the scale of production.

11.2.5 LACK OF AWARENESS AND UNDERSTANDING FOR DEVELOPMENT

Religious awareness plays a significant role in the understanding of and demand for *halal* products, and this is perceived by the stakeholders to be quite low in Kazakhstan. There is little media coverage or specific training, or education related to the features or needs of the *halal* industry. Additionally, for Kazakhstan to be a major *halal* producer, it is important for there to be an understanding on *halal* trends both in the region and also other potential export regions.

11.3 RECOMMENDATIONS

11.3.1 STRATEGIC INITIATIVE 1

ENACTMENT OF A CO-OPERATIVE HALAL ASSURANCE SCHEME FOR PRODUCTS BEYOND FOOD AND DRINKS

As the existing *halal* market is primarily focused on the food and drink sector, Kazakhstan may look to leverage on the growth on that sector to link it with other potential growth areas in the *halal* sector which can be associated with it such as *halal* tourism and travelling. Kazakhstan's growing number of *halal* eateries can be included in a *halal* tourism development plan⁶² and be part of a wider overarching cooperative strategy. Public literacy particularly among entrepreneurs and related government bodies need to be enhanced with collaborations with related industry players such as the National Chamber of Entrepreneurs of Kazakhstan "Atameken" ("Atameken"). This may then be supplemented with an appropriate legal framework to enable *halal* certification process for products other than food and drinks.

11.3.2 STRATEGIC INITIATIVE 2

INTRODUCE A LEGAL FRAMEWORK FOR HALAL INDUSTRY USING FINTECH AS A PLATFORM FOR DISTRIBUTION

FinTech has become a tool and a strategical policy to increase efficiency in any form of business. The use of FinTech is easily adopted including by the people in remote areas given the right infrastructure. The development of the *halal* sector in Kazakhstan should include the e-commerce aspects for *halal* products, online trading platforms, mobile applications and direct P2P interactions for *halal* products. This is enabled and supported with the appropriate legal framework to enable the wider use of FinTech and e-commerce technology in the *halal* industry to facilitate distribution, even fund-raising and funding in a more secured and reliable manner.

⁶² Kazakhstan's halal food business value is currently estimated at USD\$3 billion and growing. "Kazakhstan's \$3 Billion Halal Food Sector", *ITE Food & Drink*, 18 April, 2017. Retrieved from [http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-\\$3-billion-halal-food-sector](http://www.food-exhibitions.com/Market-Insights/Turkey-and-Eurasia/Kazakhstan-$3-billion-halal-food-sector)

11.3.3 STRATEGIC INITIATIVE 3 ESTABLISHING A HALAL SUPPLY CHAIN THROUGH A NATIONAL HALAL HUB

A *halal* value chain refers to the spectrum of activities that serves the operation of a *halal* business including marketing, production, financing, distribution or transportation and stock. A *halal* supply chain is usually mobilized by SMEs that comprises an integrated farming industry, food and fashion as well as *halal* tourism.

Establishing a *halal* supply chain is a pre-requisite to boosting the *halal* industry and may be done via the creation of a national *halal* hub. This national *halal* hub is also a potential precursor to the regional linkages with *halal* industries in other CIS countries.

The national *halal* hub (either established within the AIFC or in Kazakhstan) can act as a centre for *halal* business ventures and enables the businesses to seek funding with specialised financing rates. Businesses can negotiate in groups upon achieving critical mass and in the preliminary period, the government may step in to via subsidization or in setting up of a *halal* development fund (such as the Malaysian Inno Fund or European Investment Fund) designed to start and sustain the process of *halal* industry development.

11.3.4 STRATEGIC INITIATIVE 4 ENCOURAGE THE ACCESS TO ISLAMIC FINANCING FOR THE PRODUCTION, MARKETING AND DISTRIBUTION OF HALAL PRODUCTS

Funding is a key element in accelerating the production, marketing and distribution of *halal* products and currently the access of *halal* businesses to Islamic financing are not facilitated due to the small Islamic financing climate with virtually non-existent Islamic microfinancing. It is proposed and is imperative that the current strategy is to synergize these two sectors and lay the foundation for both sectors to boost the growth of each other via a feedback loop. Financial inclusion for *halal* businessmen would mean financial access to financing from not just Islamic banks but also Islamic non-bank institutions and the capital market which fulfil their needs and provide affordable rates. With a diversified product market, *halal* businesses can find tailor made financing options best suitable with their needs and goals.

11.3.5 STRATEGIC INITIATIVE 5 ENCOURAGING HALAL EDUCATION AND RESEARCH AT THE ACADEMIA

Education is a key and vital component to the development of *halal* industry capability and capacity particularly among the younger generations in order to lay the groundwork for better awareness, understanding and knowledge on *halal* matters at the university level.

Our FGDs have indicate that as of now, there is only a low-to-non-existent level of research activities on *halal* sectors besides its potential and researches done independently by interested *halal* start-ups. Research grant schemes and a participatory scheme for external experts may lead to the production of high quality of research on the *halal* industry for the use of policymakers and practitioners.

11.3.6 STRATEGIC INITIATIVE 6 PUBLIC AWARENESS PROGRAMME ON THE NEED FOR PROVISION OF HALAL PRODUCTS IN THE COUNTRY

As the majority of Kazakhstan's and its surrounding countries' population are Muslim, it is naturally expected that the supply of *halal* products will gradually be taken by some as a necessity. To obtain and sustain an advantage in servicing this segment of the population, it is important for the authorities, SAMK and interested parties in Kazakhstan to initiate public awareness programs to increase the interest and knowledge on the *halal* industry within Kazakhstan.

11.3.7 STRATEGIC INITIATIVE 7

EDUCATION AND TRAINING ON HALAL CERTIFICATION TECHNOLOGIES

Certification is a form of recognition that one can accomplish in a certain field. However, the *halal* industry and modern technology are still not integrated within each other in Kazakhstan due to the lack of literacy and governmental support such as in the form of budget allocation. The use of technology may lower manufacturing cost and increase distribution of affordable *halal* products in the market.

Halal certification technology should encompass all types of *halal* products for which *halal*-ness is relevant and intensive training ought to be made available to obtain this certification.

11.4 ACTION PLAN

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to consider enabling of a <i>halal</i> assurance scheme for products beyond just food and drinks.						AIFC Authority, Ministry of Information and Social Development, Ministry of Agriculture, Ministry of National Economy, Ministry of Trade and Integration, National Center of Accreditation, Certification Centres
2.	Suggest to introduce a legal framework for <i>halal</i> industry, including on using FinTech as a platform for distribution.						AIFC Authority, Ministry of Information and Social Development, Ministry of Industry and Infrastructure Development, Ministry of Agriculture, Ministry of National Economy, Ministry of Trade and Integration, National Center of Accreditation, Certification Centres, NBK
3.	Suggest to consider establishing a national <i>halal</i> hub.						AIFC Authority, Ministry of Information and Social Development, Ministry of Industry and Infrastructure Development, Ministry of Agriculture, Ministry of National Economy, Ministry of Trade and Integration, Ministry of Agriculture, National Center of Accreditation, Ministry of healthcare,

						Atameken, Certification Centres
4.	Suggest to facilitate the access to Islamic financing for the production, marketing and distribution of <i>halal</i> products.					AIFC Authority, Atameken, Certification Centres
5.	Suggest to consider encouraging <i>halal</i> education and research as a curriculum at the university level.					AIFC Authority, SAMK, various universities, Ministry of Education and Science, Ministry of Information and Social Development,
6.	Suggest to consider forming public awareness programmes on provision of <i>halal</i> products in the country.					AIFC Authority, Atameken, SAMK, Ministry of Information and Social Development
7.	Suggest to consider education and training on <i>halal</i> certification technologies.					AIFC Authority, Ministry of Agriculture, Ministry of National Economy, Ministry of Trade and Integration, Ministry of Agriculture, National Center of Accreditation, , Ministry of Education and Science Certification Centres, Atameken,

12.1 INTRODUCTION

In the last few decades of Islamic finance development around the world, various jurisdictions have made the effort to fulfil the need for knowledgeable human resource persons by providing education in the Shari'ah and Islamic finance, as well as industry exposure. Much attention has been paid to the need for finance savvy Shari'ah experts, and professionals who understand and can apply Shari'ah principles. The efforts placed on education in Islamic Finance Roadmap 2012 has borne some fruit, but the necessity to set in place the requisite infrastructure for Islamic finance education is urgent if Kazakhstan intends to establish a reputable Islamic finance industry on its soil. There is a need to increase Islamic finance awareness and knowledge among all sections of society, from the layman to regulators.

In the coming years, financial industry players and regulators will increasingly need to adapt to the various changes to the financial ecosystem such as variable skill sets, pervasive use of digital technology and a more diffused working environment. Skills and capacity for innovation are increasingly defining any competitive edge and potential in any market's ability to achieve its full potential. The New Development Strategy Kazakhstan 2050 has outlined a vision for the nation to transform the country into a knowledge based and diversified economy. Among many of its initiatives, the government intends to improve the quality of human capital which in turn will make Kazakhstan's workforce into a highly skilled for by providing access to high quality education. The main objective of its efforts is to leverage on its highly skilled workforce to accelerate the economic growth and position of Kazakhstan as the regional economic powerhouse. In addition, Kazakhstan's current status as one of the emerging financial centers with Islamic finance will be enhanced with the AIFC at its core.

12.1.1 CURRENT LANDSCAPE

The current existing capacity for human talent and education in Islamic finance in Kazakhstan however highlights a massive gap from vision to implementation. Currently, there is only one Advanced Diploma in Islamic Finance programme, a postgraduate diploma-level qualification offered via distance learning offered by the Bahrain Institute of Banking and Finance in Kazakhstan, one Masters in Islamic Finance and one PhD programme in Islamic Finance by Al-Farabi Kazakh National University, state educational grants are allocated to these programmes. In addition, there are several universities that offer some elective courses on Islamic banking, *takaful* and Islamic law to their students. These are Al-Farabi Kazakh National University, L. Gumilyov Eurasian National University, Turan University, New Economic University and S. Toraihyrov Pavlodar State University.

In terms of continuous learning and professional development, the BCPD offers a range of professional programs in Islamic finance developed by recognized by reputable institutions such as the Bahrain Institute of Banking and Finance (BIBF) (Bahrain), AAOFI (Bahrain), International Centre for Education in Islamic Finance (INCEIF, Malaysia) and Chartered Institute for Securities and Investment (CISI) (United Kingdom). Also, there is a Certified Islamic Banker program offered in collaboration with General Counsel for Islamic Banks and Financial Institutions (CIBAFI, Bahrain). Most of these programmes are initiative taken by the BCPD to build supply of talents in Kazakhstan. The plan for the BCPD is to retrain over 5000 local specialists until 2020 across 20 professional areas.

On the top of all the aforementioned programmes, there are various workshops, seminars and conferences conducted in Kazakhstan to raise the level of awareness by regulators and private institutions. Last but not least, in year 2013, Islamic finance has been included into the list of specialties for granting International Scholarship 'Bolashak' (The Future) of the President of Kazakhstan to obtain master degrees in programmes offered by reputable higher learning institutions such as Durham University, Nottingham University, Birmingham University and New Orleans University.

12.2 ISSUES AND CHALLENGES

A brief on the current landscape signify some measures and initiatives taken by various parties to build a strong supply of human of capital. Nevertheless, there are still immense gaps in the talent building process and ecosystem.

12.2.1 SHORTAGES OF QUALIFIED ACADEMICIAN, SKILLED TALENT POOL AND SHARI'AH EXPERTS

A cursory glance at the profile of Kazakhstan's academicians and subject matter experts shows the existence of a gap in which there are a lack of qualified instructors or trainers in the area of Islamic finance. Most of the experts in Kazakhstan are trained in conventional finance and have very little if not no formal training in Islamic finance. In fact, the most critical domain is Shari'ah where there is an acute shortage of qualified Shari'ah advisors. Often the shortage of experts is in relation to the lack of a workforce that understands the principles and depth of Islamic financial markets and instruments. This shortage is typically what hampers any effort to maintain growth momentum.

Currently, the BCPD offers all its programmed in collaboration with either local or foreign partners. While this plan might be effective in the short term, the sustainability of any continuing professional development regime depends on the availability and the knowledge transfer between home-grown experts. This creates a domestic academic ecosystem where knowledge can be retained, and any development is not hampered by the occurrence of any brain-drain phenomena. Furthermore, a sufficient size of local capacity creates opportunities to begin outward expansion and truly make Kazakhstan and the AIFC as the regional center for talent and knowledge programs.

12.2.2 UNSTRUCTURED ACADEMIC CURRICULUM, TRAINING AND TECHNICAL PROGRAMMES

Apart from several courses or even subjects attached to a general degree program that are offered in several higher learning institutions, there is no locally structured Islamic finance qualifications or degrees offered in in both the academia and the industry. Currently, any academic curriculum, qualification or degrees are simply offered by foreign partners and are structured towards professional development rather than truly academic qualifications. Some of the contents for these courses or subjects are perhaps too generic and may not able to address the unique setting of the AIFC and Kazakhstan.

In addition, the setting of the AIFC that adopts English law in contrast to the mainland with civil law along with the dynamics of the ongoing Islamic finance legal regulatory development requires a customized curriculum which should take these two factors into account to ensure that any graduates of such school is well-equipped and ready to serve into the Islamic finance sector.

12.2.3 OVERDEPENDENCE ON COLLABORATIVE PARTNERS FOR TRAINING AND PROFESSIONAL QUALIFICATION

Currently, most of the capacity building initiatives within the AIFC are managed by the BCPD. Nonetheless, there is a limitation in capacity or expertise within the BCPD in relation to the domain of Islamic finance. In particular, with regards to the BCPD's capability to develop contents for industry training. As such, related institutions have to rely on collaborative partners for contents and academic/professional qualifications.

12.2.4 SHORTAGE OF LEARNING MATERIALS AND RESEARCH PAPERS.

As there are limited research activities conducted on Islamic finance whether in private or public universities around and throughout Kazakhstan, this in turn limits the availability of learning materials (especially new learning materials) in particular matters, issues, cases and circumstances related to Kazakhstan's financial and

Islamic financial sector. Incidentally, the lack of a focused framework or effort may also impact on the availability of foreign learning materials whether translated or not for use within Kazakhstan for interested parties whether for academic or professional development purposes.

These factors highlight an urgent need to either (a) develop local learning materials such as case studies, textbooks and manuals; or (b) the importation and translation of foreign learning materials for local usage. There is also certainly a need to document the development and the practices Islamic finance in Kazakhstan. By doing so, the learning process will be more contextualized and relevant to learners whether they seek to practice such knowledge within the AIFC and Kazakhstan or abroad.

12.2.5 NEED FOR A REGIONAL CENTRE OF EXCELLENCE FOR ISLAMIC FINANCE

The central Asian region historically has prominently featured centers of knowledge which serve not just the local communities but globally as well via the well-known cities such as Bukhara and Samarkand. However, in recent times, there is no dedicated academic institution or a centre of excellence that serves the region and specifically with a focus on Islamic finance. This is both a regional gap and also an opportunity. The lack of such an institution has allowed for the continued absence of any or a systematic or structured process to develop Islamic finance curriculum and capacity in Kazakhstan.

Consequently, there are no locally aligned standards for such curriculum development and academic/professional qualifications that can cater to the specific needs of the region especially in the area of Islamic finance. However, this has presented a first mover advantage to an institution that seizes the initiative. The AIFC and Kazakhstan have the potential to be an exporter of knowledge to the region instead, giving it a cultural “*soft power*” akin to the influence of British, American and Australian tertiary education environment.

12.3 RECOMMENDATIONS

With the need to build a qualified skilled workforce being paramount and since the current capacity development programme is more ad-hoc and unstructured, this Master Plan aims to differentiate the AIFC and the BCPD from its competitors with a conspicuous differentiating value. Any future talent program should cover and build capacity for all of the above initiatives as recommended by this Master Plan. The initiatives outlined in this section serve as the guiding blocks to building the soft-infrastructure and the enablers for the other sections.

It is highly recommended that the focus of the Islamic finance programs should, in addition to the focus on the more traditional Islamic finance areas, also embrace universal values such as ethical financing, green financing and sustainability which have already imbued contemporary discourse and practices. Future programs must also have a focus on Islamic social finance, the halal economy and the digital economy. Most importantly, all talent programs must prepare the Kazakhstan’s workforce to become as resilient as possible to address global and regional issues. The ability to provide solution or panacea for global Islamic finance matters will become a distinct value proposition for the AIFC. As such, premised on the strategic pillars, we recommend 6 strategic initiatives with action plans for talent and capacity development. In terms of implementation, it can be divided into three phases; short-term, medium-term and long-term.

Strategic Initiatives	Recommendations
1 Increase awareness among the youth and the young professionals on Islamic finance knowledge and the career potentials of the Islamic finance industry.	<ul style="list-style-type: none"> i. Introduce Islamic finance informally within the school curricula through extracurricular activities, competitions, and games (gamification of any existing economic syllabus); ii. To continue hosting major international conferences and seminars on Islamic finance; and iii. To create a marketing campaign for the BCPD as the premier professional development centre for the region.
2 Foster partnerships between the institution of higher learning institutions with the industry.	<ul style="list-style-type: none"> i. To structure a blended curriculum with a focus on industry readiness, experimentation and industry-based learning; and ii. To develop a short term (6-months) internship program for fresh graduates and young professionals with reputable Islamic financial institutions (either local or abroad).
3 To upgrade the skills and knowledge of the existing workforce.	<ul style="list-style-type: none"> i. To develop a local Islamic finance professional certificate with three levels of competency; and ii. To develop a local Continuous Professional Education framework.
4 To create a pool of qualified academic, trainers and Shari'ah advisers.	<ul style="list-style-type: none"> i. To provide a good number of scholarships to pursue postgraduate education (such as MIFP, MSc and PhD); and ii. To provide for an outbound mobility program for local academics to pursue higher education or research opportunities at reputable foreign universities.
5 To increase collaboration with reputable academic and training institution.	<ul style="list-style-type: none"> i. To offer joint degree with reputable universities in the field of Islamic finance; and ii. To leverage on the online learning capabilities offered by partnering institutions.
6 Establish a regional center of excellence.	<ul style="list-style-type: none"> i. To establish a regional center of excellence within the AIFC that is a go-to educational institution for Islamic finance and attracts students from within Kazakhstan and the CIS region.
7 Create an AIFC Islamic finance media channel to disseminate information and awareness to all levels of society.	<ul style="list-style-type: none"> i. To establish a media channel with a range of programmes on Islamic finance for different segments of society.

12.3.1 STRATEGIC INITIATIVE 1 TO INCREASE AWARENESS AMONG THE YOUTH AND YOUNG PROFESSIONALS ON THE CAREER POTENTIALS IN THE ISLAMIC FINANCE INDUSTRY

The intent of relevant stakeholders whether they are the AIFC or universities is to make the public and the participants appreciate the presence and importance of an alternative financial system such as Islamic finance. This approach can be direct or in conjunction under the banner of sustainable and responsible finance. At the same time, the public ought to be made aware of the potential of Islamic finance industry, in term of job

creation, attracting new capital to Kazakhstan and strengthening its financial system. The addition of talented young business leaders who understand the ethical principles of Islamic finance will spread the acceptance and offering of Islamic finance products to all other segments of the market.

(i) To introduce Islamic finance Informally in school curricula through extracurricular activities and gaming

The AIFC could introduce a module or extracurricular activity that can be integrated in schools and enable students to have early basic exposure to the economy, financial system and Islamic finance. The contents can also be delivered as part of an effort in educating young students of the importance of personal financial management.

(ii) To continue to host major international conferences in both English and the Russian language

Apart from hosting major international events, the AIFC needs to have a flagship conference event that reflects its Islamic finance vision and strategy. In addition to discussing general ideas, this conference will be a platform for promoting business opportunities to the wider financial community. It is at this conference that there will be a platform for policymakers and academician to get together and deliberate regional issues. This conference could be the main event for reflecting the region's and Russian speaking community's aspirations with regard to Islamic finance.

(iii) To increase marketing campaigns to communicate the value proposition of Islamic finance

In general, the AIFC's marketing campaigns ought to start from a more holistic perspective that explains the value propositions of Islamic finance's sustainable and responsible financing model to the general public. In supporting the entrepreneurial culture of Kazakhstan, the population of Kazakhstan remains as its most promising asset to diversify the economy and a strong base for Islamic finance to grow. Continued education programs should be continued or forged with other similar programs such as the DAMU 'Distance Learning' training program. The volume of campaign should be spaced and scheduled in line with marketing campaigns of other sub-sectors such as the halal industry, *zakat* and *waqf*.

12.3.2 STRATEGIC INITIATIVE 2 FOSTER PARTNERSHIP BETWEEN INSTITUTIONS OF HIGHER LEARNING AND THE INDUSTRY

The AIFC should prepare for the development of a curriculum on Islamic finance and this must take into consideration the knowledge and know-how that are formed within the financial industry. A bottom-up approach is chosen as it will provide higher learning institution a starting point of putting practices into a structured curriculum either in a form of case study or manual while the curriculum will progress to include industry partnerships. Moreover, the partnership will also allow students or young graduate to gain valuable experience and knowledge from the industry. Any internship or attachment should not be limited to organization or company within Kazakhstan but also include reputable Islamic finance institution globally and also regulators.

(i) To structure a blended curriculum to produce industry ready graduates with a greater opportunity for experiential and problem-based learning.

The relevant stakeholder in this initiative with the relevant budget ought to structure a grant or sponsorship program for the industry to develop new and more innovative learning materials either in the form of case studies, manuals, textbooks or even other non-traditional forms of materials. Islamic finance requires expertise and experts who not only possess the comprehensive know-how of finance but also the technical knowledge of the Shari'ah. A critical gap that will need to be addressed is the need and the provision of Shari'ah compliant product developers and Islamic financial engineers. It is these positions within the corporate participants of Islamic finance that will structure the innovative Shari'ah compliant solutions that are specifically tailored for

the needs of the regional market. A grant program will give this type of workforce the financial room to innovate.

- (ii) To have a six-month internship programme at reputable Islamic finance institutions (locally and abroad) for fresh graduates and young professionals**

It is proposed that the AIFC develops a six-month internship program (akin to the Financial Sector Talent Program (FSTP) in Malaysia) for entry level executives. The AIFC may collaborate with corporate partners for this program both within and out of the AIFC and Kazakhstan. It is important for the AIFC in developing this internship program to not just focus on finance-based departments but also Shari'ah departments whose knowledge is crucial, as they are responsible for overseeing overall operations and making sure these operations are in line with the Shari'ah. Specific internship programs on the functions of Shari'ah auditors, Shari'ah reviewers, Shari'ah researchers and Shari'ah compliance analyst are all key crucial areas for Islamic finance participants. This internship program in the short run can provide for a stop-gap in the current market while also provide a sustainable way for entry level executives for the future to prepare for the specific role they will play within the industry.

12.3.3 STRATEGIC INITIATIVE 3 UPGRADE THE SKILLS AND COMPETENCIES OF EXISTING WORKFORCE

Shortages of talent and skills are always considered as impediments towards the building of a successful industry, so long as the majority of the current workforce are not savvy with Islamic finance products, contracts and transactions. The intent of this initiative is for young professionals or new players to acquire the relevant skills and accreditations. As such, they will have strong product knowledge and industry specific capabilities. The phases of implementation of this initiative can be measured physically as each infrastructure are put in place.

- (i) To develop certification of the skills level or competencies in both English and the Russian language**

The AIFC in collaboration with the relevant stakeholders could develop a three level qualification system which can be tentatively classified as 'basic', 'intermediate' and 'advance' levels for Islamic finance players in the region. Upon completion of all three levels, the candidate will be conferred a Chartered Islamic Finance Professional ("CIFP") certificate. With this certification, the AIFC can help the neighboring countries within region to develop their own Islamic finance capability. The AIFC must look to prepare and play its role as a driver for Islamic finance development in the region, by tapping into the capabilities of the regions' approximately 100 million strong Muslim populations as providers and consumers of Islamic finance products. The program should be offered both in English and Russian.

- (ii) To develop a formal structure for continuous learning akin to continuing professional education (CPE)**

In the interim, the AIFC ought to offer specialized short courses on product knowledge, structuring and distributing deals, regulation and Shari'ah as a "lite" version of the CIFP certificate. The AIFC should collaborate with the stakeholders via a curriculum task force to be the first mover in doing so.

12.3.4 STRATEGIC INITIATIVE 4 CREATE POOLS OF QUALIFIED ACADEMICS, TRAINERS AND SHARI'AH ADVISERS

The AIFC ought to promote the offerings of various academic qualifications in Islamic finance at the various universities in Kazakhstan and boost the number of qualified academicians, preferably up until the PhD level

in Islamic finance. Additionally, the AIFC needs to develop a competency framework for capacity building for these universities which will require qualified trainers and practitioners. The framework should identify methods of channeling the right training and trainers as and when required by the universities.

- (i) To provide a good number of scholarships to pursue postgraduate education (such as MIFP, MSc and PhD)**

The AIFC and the government of Kazakhstan should introduce and increase the number of scholarships available for pursuing academic and professional qualifications in Islamic finance. This scholarship program can also be implemented by a matching grant system with reputable universities and private entities.

- (ii) To create an outbound mobility program for local academics to pursue research or training at reputable universities in the field of Islamic finance**

The AIFC in developing increased partnership with local universities should design a semester long outbound mobility program either with universities or financial institutions, as placements upon which research efforts can be made easier and smoother.

12.3.5 STRATEGIC INITIATIVE 5 COLLABORATE WITH REPUTABLE ACADEMIC AND TRAINING INSTITUTIONS

Partnerships and collaborations with reputable foreign institutions will ease and expedite all of the above aforementioned strategies.

- (i) To offer joint degrees with reputable universities in the field of Islamic finance**

The AIFC or any local universities in Kazakhstan should offer a dual master's degree with a partnering reputable institution such as INCEIF, Durham University or Institute of Islamic Banking and Finance, International Islamic University Malaysia (IIUM).

- (ii) To leverage on online learning facilities offered by partner institutions**

AIFC should utilize or share online platforms developed by any of its partner institution through Massive Open Online Courses (MOOCs) and Moodle Learning Management System. This will allow the AIFC to minimize its cost to develop contents and at the same time benchmark its curriculum.

Once there are a sufficient number of qualified academicians, any university in Kazakhstan can start offering a full master's or bachelor's degree in Islamic finance.

12.3.6 STRATEGIC INITIATIVE 6 ESTABLISH A REGIONAL CENTRE OF EXCELLENCE

It is important for Kazakhstan to have a dedicated institution that coordinate the capacity building agenda.

- (i) To offer programmes and training and to conduct industry research and policy works related to Islamic finance.**

AIFC must position itself as a centre for Islamic finance development and exporter of knowledge.

**12.3.7 STRATEGIC INITIATIVE 7
CREATE AN AIFC ISLAMIC FINANCE MEDIA CHANNEL TO DISSEMINATE
INFORMATION AND AWARENESS TO ALL LEVELS OF SOCIETY**

- (i) Establish a media channel with a range of programmes on Islamic finance for different segments of society

There is a need for a media channel that is easily accessible to the public that offers a wide range of programmes and content on Islamic finance. The programmes could be developed to suit each intended target group, from schoolchildren to finance professionals. A basic example of a dedicated media channel already implemented in Kazakhstan is the Youtube channel of the Ministry of Statistics which the AIFC can sought to emulate.

12.4 ACTION PLAN

**12.4.1 STRATEGIC INITIATIVE 1
TO INCREASE AWARENESS AMONG THE YOUTH AND YOUNG
PROFESSIONALS ON THE CAREER POTENTIALS IN THE ISLAMIC
FINANCE INDUSTRY**

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to introduce Islamic finance content informally within the school curriculum through extracurricular activities, competitions, and games (gamification of any existing economic syllabus).						AIFC Authority, Ministry for Education and Science, Universities
2.	To continue hosting international conferences and seminars on Islamic finance.						AIFC Authority

**12.4.2 STRATEGIC INITIATIVE 2
FOSTER PARTNERSHIP BETWEEN INSTITUTIONS OF HIGHER LEARNING
INSTITUTIONS AND THE INDUSTRY**

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to structure a blended curriculum with a focus on industry readiness, experimentation and industry-based learning.						AIFC Authority, Universities
2.	Suggest to develop a short term (6-months) internship program for fresh graduates and young professionals with reputable Islamic financial institutions (either local or abroad).						AIFC Authority, Universities, Industry players, Ministry of Education and Science, Centre for International Programs (Bolashak)

12.4.3 STRATEGIC INITIATIVE 3 UPGRADE THE SKILLS AND COMPETENCIES OF EXISTING WORKFORCE

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to develop a local Islamic finance professional certificate with three levels of competency.						AIFC Authority, Universities
2.	Suggest to collaborate with the existing distance book learning programme of DAMU to introduce the entrepreneurs to Islamic financing.						AIFC Authority, DAMU

12.4.4 STRATEGIC INITIATIVE 4 CREATE POOLS OF QUALIFIED ACADEMICS, TRAINERS AND SHARI'AH ADVISERS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to provide for an outbound mobility program for local academics to pursue higher education or research opportunities at reputable foreign universities.						AIFC Authority, Ministry of Education, Universities

12.4.5 STRATEGIC INITIATIVE 5 COLLABORATE WITH REPUTABLE ACADEMIC AND TRAINING INSTITUTIONS

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Suggest to offer joint degree with reputable universities in Islamic finance field.						AIFC Authority, Universities
2.	To leverage on the online learning capabilities offered by partnering institutions.						AIFC Authority
3.	Suggest to adopt partner university program structure and curriculum.						AIFC Authority, Universities

**12.4.6 STRATEGIC INITIATIVE 6
ESTABLISH A REGIONAL CENTRE OF EXCELLENCE**

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Establish a regional centre of excellence within the AIFC.						AIFC Authority

**12.4.7 STRATEGIC INITIATIVE 7
ESTABLISH A MEDIA CHANNEL ON ISLAMIC FINANCE**

No	Work Programme	2020	2021	2022	2023	2024	Stakeholder
1.	Create an AIFC Islamic Finance media channel to disseminate information and awareness to all levels of society.						AIFC Authority

CHAPTER 13: IMPLEMENTATION PLAN

13.1 QUICK WINS AND MEDIUM TERMS PLANS

13.1.1 QUICK WINS

LAWS AND REGULATIONS

- i) Establish a high-level committee for the Islamic financial sector involving key regulatory authorities and policy makers who will coordinate and collaborate to drive the implementation of this Master Plan; and
- ii) Adopt an industry-driven Shariah governance model benchmarked against the IFSB and AAOIFI standards and industry best practices.

INFRASTRUCTURE

- i) Develop an Islamic seeding strategy to attract presence of global asset managers and offer innovative and diverse fund structures;
- ii) Set up a benchmark and standard of performance in the form of indices for Islamic finance institutions;
- iii) Issuance of a sovereign sukuk as a benchmark for the development of the corporate Sukuk market.
In the alternative, a quasi-sovereign sukuk by an SOE;
- iv) Develop an Islamic Finance Department in the regulatory body.

INSTITUTIONS

- i) Enable Islamic financial service solutions through technological integration with platform technology such as P2P financing;

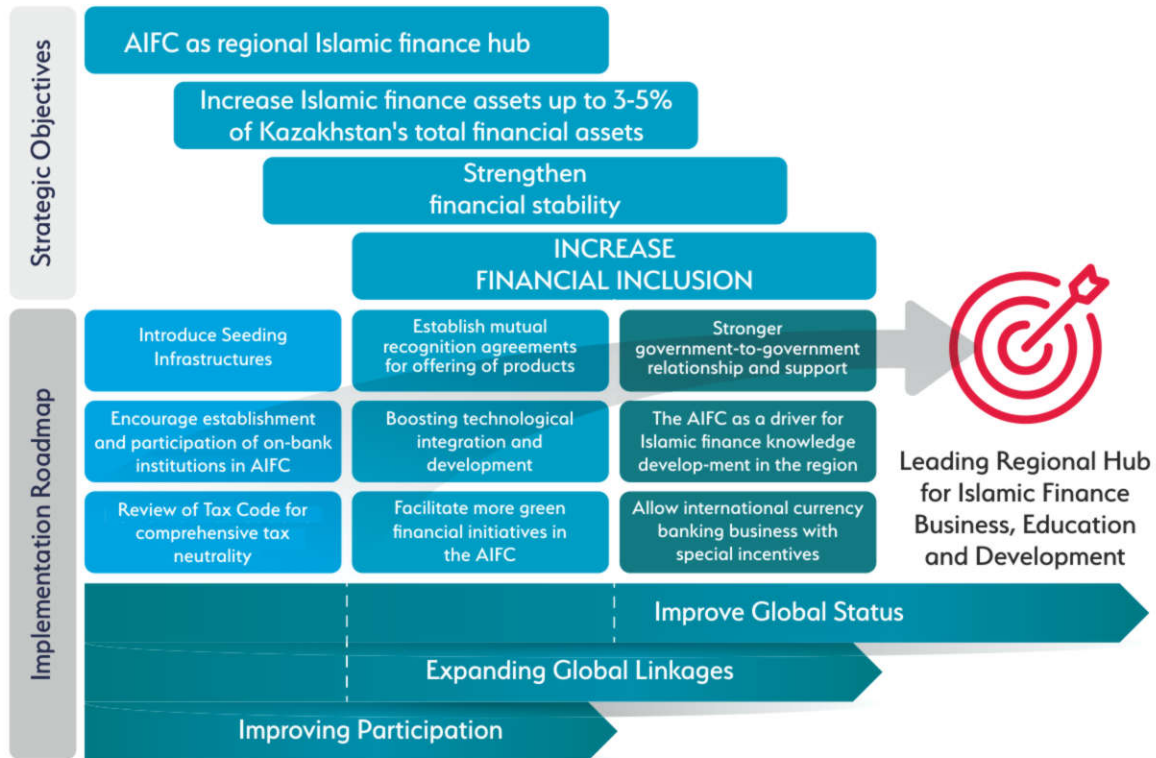
13.1.2 MEDIUM TERMS PLANS

Year	Plans
2021-2022	<ul style="list-style-type: none">▪ Develop an Islamic Finance Department in the regulators;▪ Establish a high-level coordination committee between the relevant bodies;▪ Issue the first local currency sovereign <i>Sukuk</i>;▪ Issue the first local currency domestic corporate <i>Sukuk</i> (by an SOE);▪ Pass the necessary legal amendments to the existing legal framework to:<ul style="list-style-type: none">- Establish the first Islamic banking window;- Establish the first <i>takaful</i> window;- Enable use of varied Shari'ah contracts as approved by the Councils for Islamic Financing Principles;- Implement a universal deposit insurance scheme;- Enable Islamic microfinance, cooperatives and Kazpost accounts.▪ Increase Islamic investments by the UAPF;▪ Establish a dedicated regional Islamic finance research and training institution; and▪ Harmonise <i>halal</i>-certification standards.

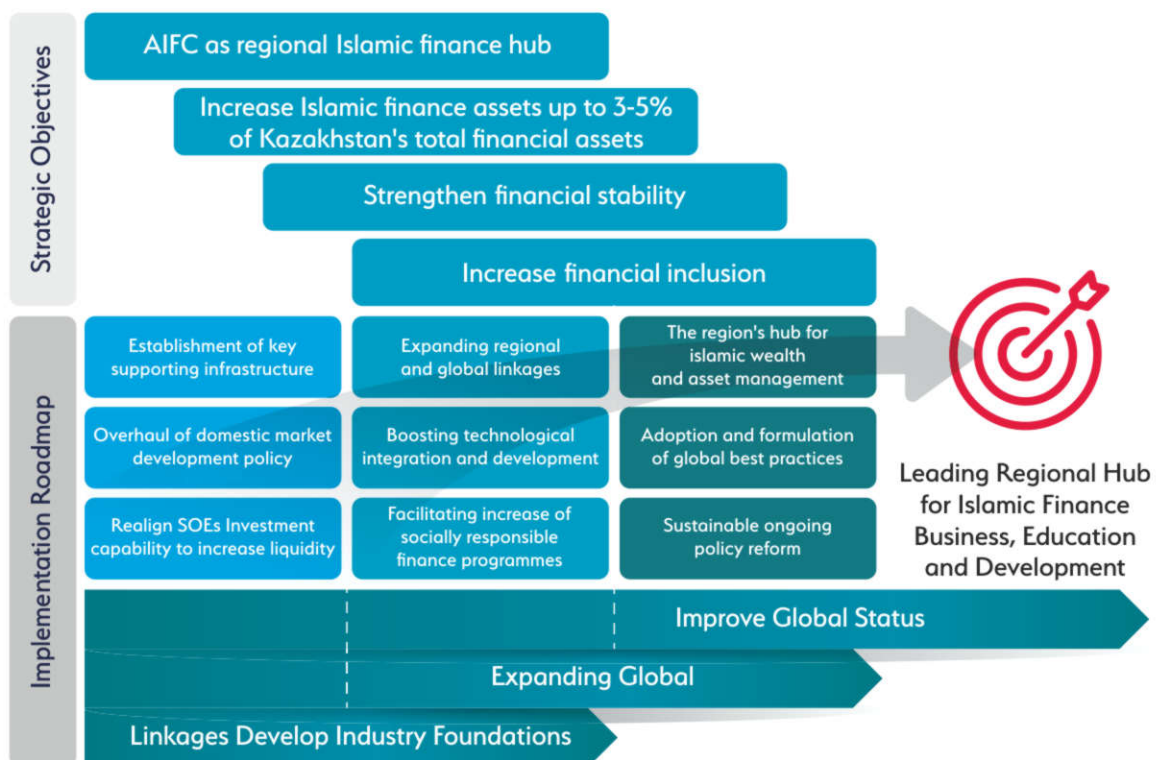
13.2 PHASED IMPLEMENTATION PLAN

We propose a multi-phased approach to implementing and achieving four strategic objectives deliver the full vision of this Master Plan, spanning its short, medium and long-term phases:

For the AIFC



For Kazakhstan



As a test case for the development of the industry’s foundations, we have also outlined a number of simulated initiatives as included as Appendix 1 which may be attempted in an effort to increase the total Islamic finance assets while giving a foundation for the business side of Islamic finance in the AIFC.

13.3 COORDINATING COMMITTEE AND MONITORING MECHANISM

The implementation of this Master Plan can only be sustained and effective upon the creation of a high-level coordinating committee comprising of the relevant stakeholders for the implementation to this Master Plan (the “Committee”) due to the nature of the working programmes as contained herein. At its minimum, the Committee should comprise of the following:



The Committee should be an independent body (preferably under the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan) mandated and empowered with the following functions:

- To monitor each working programme as recommended herein;
- To ensure and coordinate cooperation between the stakeholders;
- To review the implementation of each working programme at the end of the allocated period as per the schedule as provided within each chapter herein; and
- To propose remedial measures (if any) as and when necessary.

The Committee ideally should also be empowered with access to direct reporting lines of each stakeholder as and when necessary to ensure that each action taken by any stakeholder and by the Committee is done in a timely manner. Since the work programme schedules are proposed on an annual basis, the Committee is recommended to obtain quarterly progress reports on each work programme upon the start of its implementation. These reports should contain the following contents: performance details, issues and problems, approved changes (if any), risk management plan and status, and subsequent steps.

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ACKNOWLEDGEMENT

This Islamic Finance Master Plan for The Astana International Financial Centre and The Republic of Kazakhstan (“**Master Plan**”) was prepared by **ZICO Shariah**. The work was carried out under the overall direction of Dr. Aida Othman, Director of ZICO Shariah, as the Project Director and Prof. Dato’ Dr. Mohd Azmi Omar as Team Leader. Dr. Aida Othman is supported by her team comprising Yoon Chee Loon, Lily Adelina Hashim, Mohd Ridhuan Md Kamal, Wan Madihah Wan Azmi, Nazri Ramli, Nur Adibah Adnan, Muhammad Syamil Mohd Ali, Ahmad Ab Hamid, Datuk Seri Dr. Nik Norzrul Thani and Chew Seng Kok.

The project team was advised by the following subject matter experts and consultants: Dr. Ruslan Nagayev, Radzuan Tajuddin, Madzlan Mohamad Hussain, Dr. Akhmad Affandi Mahfudz, Dr. Mohammad Mahbubi Ali, Dr. Ziyaad Mahomed, Dr. Mohamed Eskandar Shah Mohd Rasid, who provided expertise and substantive input. The team is further aided by the AIFC Authority led by Mr. Alibek Nurbekov and Ms. Madina Tukulova as the AIFC representatives and liaisons. ZICO Shariah would like to convey a special gratitude to the entire AIFC Authority for their excellent support and assistance throughout the project period.

ZICO Shariah also would like to convey its deepest gratitude to all stakeholders including all FGD parties, the AIFC Advisory Council on Islamic Finance, the various departments of the AIFC, the NBK, the DBK and Halyk Finance, for providing the project team with both primary and secondary data, literature and statistics which had informed deliberations for the Master Plan. Lastly, ZICO Shariah would like to thank the Islamic Development Bank, the AIFC Authority and the Government of Kazakhstan for the issuance of this Master Plan.

APPENDIX1

A FGD Meetings Round 1	
Duration: 5 days (29 April 2019 – 30 April 2019; 2 May 2019 – 4 May 2019)	
Interviewers: <ul style="list-style-type: none"> ● Dr Aida Othman ● Dr Mahbubi Ali ● Mr Radzuan Tajuddin ● Dr Akhmad Affandi ● Mr Yoon Chee Loon ● Mr Mohd Ridhuan 	Interviewees: <ul style="list-style-type: none"> ● DBK (Nur-Sultan, 29 April 2019) ● AIFC's Fintech Hub (Nur-Sultan, 29 April 2019) ● Astana Branch of Zaman Bank (Nur-Sultan, 29 April 2019) ● AIFC Islamic Finance and Business Hub (Nur-Sultan, 29 April 2019) ● Astana Financial Services Authority (Nur-Sultan, 29 April 2019) ● Spiritual Administration of Muslims of Kazakhstan (Nur-Sultan, 30 April 2019) ● Akyl-Kenes Consulting Firm (Nur-Sultan, 30 April 2019) ● AIFC Investment Solutions Department (Nur-Sultan, 30 April 2019) ● AIFC Business Development Office (Nur-Sultan, 30 April 2019) ● Mutual Insurance Society 'Takaful' (defunct) (Nur-Sultan, 30 April 2019) ● AIFC Green Finance Hub (Nur-Sultan, 30 April 2019) ● KazAgroFinance JSC (Nur-Sultan, 30 April 2019) ● Bureau for CPD AIFC Ltd. (Nur-Sultan, 30 April 2019) ● AIFC Court and International Arbitration Centre (Nur-Sultan, 30 April 2019) ● Kazakhstan Ministry of Finance, State Borrowing Department (Nur-Sultan, 30 April 2019) ● Al-Farabi Kazakh National University (Almaty, 2 May 2019) ● Al-Hilal Islamic Bank JSC , Kazakhstan (Almaty, 2 May 2019) ● JSC Unified Accumulative Pension Fund (Almaty, 2 May 2019) ● Halal Quality Centre (Almaty, 2 May 2019) ● NBK (Almaty, 3 May 2019) ● Kazakhstan Stock Exchange (Almaty, 3 May 2019) ● JSC Al-Saqr Finance (Almaty, 3 May 2019) ● Mutual Insurance Society 'Takaful' (defunct) (Almaty, 3 May 2019) ● JSC DAMU Entrepreneurship Development Fund (Almaty, 3 May 2019) ● Kazakhstan Ijara Company JSC (Almaty, 3 May 2019) ● Association of Microfinance Organizations (Almaty, 4 May 2019) ● Integrites Law (Almaty, 4 May 2019) ● Halyk Finance JSC (Almaty, 4 May 2019) ● Astana International Exchange (Almaty, 4 May 2019)

B FGD Meetings Round 2	
Duration: 3 days (1 July 2019 – 3 July 2019)	
Interviewers: <ul style="list-style-type: none"> ● Dr Aida Othman ● Prof Dato' Dr Azmi Omar ● Mr Radzuan Tajuddin ● Dr Ziyaad Mahomed ● Dr Ruslan Nagayev 	Interviewees: <ul style="list-style-type: none"> ● "Baiterek" National Management Holding JSC (Nur-Sultan, 2 July 2019) ● Kazakhstan Mortgage Company JSC (Nur-Sultan, 2 July 2019) ● Ozara Finance (Nur-Sultan, 2 July 2019)
C FGD Meetings Round 3	
Interviewers: <ul style="list-style-type: none"> ● Dr Aida Othman ● Prof Dato' Dr Azmi Omar ● Mr Radzuan Tajuddin ● Dr Ziyaad Mahomed ● Dr Ruslan Nagayev 	Interviewee: <ul style="list-style-type: none"> ● Mr Edige Alpysbay of Amanie Advisors, Kazakhstan (Nur-Sultan, 4 October 2019)
D Other FGD Meeting(s)	
Interviewers: <ul style="list-style-type: none"> ● Dr Aida Othman ● Mr Yoon Chee Loon ● Mr Mohd Ridhuan 	Interviewee: <ul style="list-style-type: none"> ● Mr Daud Vicary of the AIFC Islamic Finance Advisory Board (Kuala Lumpur, 9 May 2019)

We also held various discussions with other parties in relation to the development of the financial infrastructures in Kazakhstan, including but not limited to, with Mr Afiq Johar (an independent contractor for the AIFC Fintech Hub), Mr Taranjeet Singh (previously an External Advisor to the government of Kazakhstan) and Ernst & Young (Kazakhstan and Russia Office).

APPENDIX 2

Selected Simulated Initiatives⁶³.

Our current simulated benchmarks are as follows:

- Total banking assets: KZT25.247 trillion (as at August 2019)
- Total Islamic banking assets: KZT24.6 billion (as at April 2019)
- Current ratio of Islamic banking assets to total banking assets: 0.097%

KMC

The KMC was originally formed in 2000 as a subsidiary of the NBK and was the first organisation to issue mortgage bonds within the CIS Region in 2002. The KMC successfully expanded operating branches in all 15 regions of Kazakhstan by 2004. KMC stocks are listed on KaSE in 2005. In 2013, the entirety of KMC's stocks were transferred to Baiterek⁶⁴.

The Baiterek was established in May 2013 through the "Decree of the President of the Republic of Kazakhstan No.571" of 22nd May 2013 and is 100% owned by the Ministry of Investment and Development of the Republic of Kazakhstan via the State Property and Privatization Committee of the Republic of Kazakhstan. As of 2019, Baiterek is still the sole shareholder of KMC⁶⁵.

The KMC's mission is "to increase the affordability of the housing market in Kazakhstan" and its vision is "to be an effective financial operator of the state policy in the field of providing affordable housing to the population of the Republic of Kazakhstan through the mechanisms of mortgage lending and the provision of rental housing"⁶⁶.

The KMC's current products and services are:

1. "Nurly Zher" (Leasing Purchase) Programme

- A long-term lease purchase financing programme typically for a term of 20 years to cater for "socially unprotected categories of citizens of the Republic of Kazakhstan".
- Participants are provided with the purchase option to transfer the house to the lessee at the end of the lease term with the possibility for the lease to obtain an early redemption of the housing unit.
- The KMC listed that the rental cost for each 1 sq. m is KZT 1,120 (for the regions of Almaty and Nur-Sultan) and KZT 924 (for other regions).
- The programme by KMC is part of a larger government programme under the Baiterek to provide affordable housing and KMC's part is conducted in collaboration with "Zhilstroysberbank of Kazakhstan" JSC (which disburses the government funds for the construction of the houses) and "Fund of Guaranteeing of Housing Construction" JSC (which guarantees all construction projects under the Nurly Zher Programme), both organisations are also fully owned subsidiaries of the Baiterek.
- The Nurly Zher programme is currently the KMC's leading and largest programme making up to approximately 69% of the KMC's current portfolio.

⁶³ We have prepared and proposed a few simulated initiatives aimed at increasing the amount and share of Islamic finance assets within the AIFC and Kazakhstan. All simulation are hypothetical assumptions based on the data as publicly available to us and are benchmarked against the Total Islamic Banking Assets and Total Banking Data of the National Bank of Kazakhstan.

⁶⁴ "Annual Report 2017", *JSC Mortgage Organisation Kazakhstan Mortgage Company*, 28 February, 2018. *the latest audited report was not available for public at the time of this simulation.

⁶⁵ *ibid*

⁶⁶ *ibid*

2. Refinancing Programme

- A refinancing programme designed to encourage existing housing loans in foreign currency to convert into KZT.
- The interest rate on the existing housing loans issued in foreign currency is locked at 12% per annum while if to refinance via KMC in KZT the interest rate on loans will not be more than 3% per annum.

3. "Orda" Mortgage Programme

- A mortgage loan programme for individuals to purchase apartments in the primary and secondary market via agent banks.
- The maximum term for "Orda" mortgage loans is 240 months.
- Under the "Orda" programme, borrowers may only borrow up to 50% of the residential property cost (subject to further terms and conditions imposed) and the ceiling loan amount is KZT65 million / US\$ 169,705.25.

4. Partnership with STB's Programme

- A programme where the KMC purchases over the mortgage loans of a retail housing-loan borrower and the partner bank will act as a trustee who carries out the loan servicing and collects monthly repayments to the KMC.
- As of now, the KMC's list of partner banks consists of 15 STBs, including the largest banks in Kazakhstan and 2 specialized mortgage organizations.

Proposed Simulated Initiative

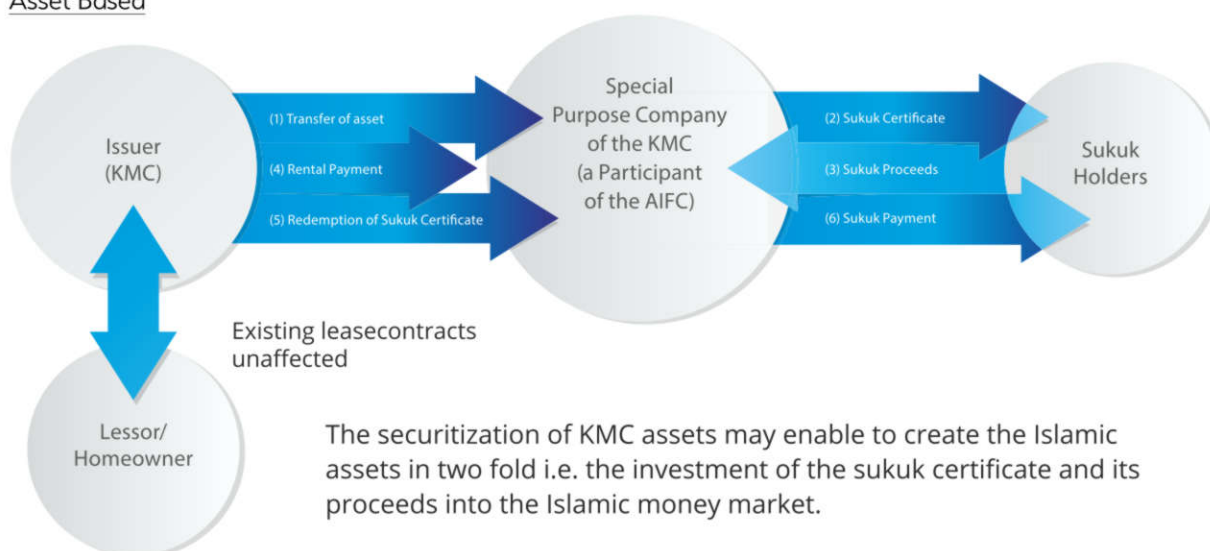
We proposed an initiative to democratize the KMC's Nurly Zher programme by securitizing it into an SDG *ijarah Sukuk*. The assets of the Nurly Zher programme is suitable for such structure as it is wholly owned by the KMC and will be transferred to the participants only upon a long term.

Our initiative is also aimed at achieving the following secondary goals:

- i) liberating the programme's funding from over-reliance on government funds;
- ii) freeing the government's expenditure budget 'off book';
- iii) allowing the KMC to participate in the Islamic finance industry; and
- iv) issuing the first SDG or green *Sukuk* in Kazakhstan.

The proposed structures are as follows:

Asset Based



We have benchmarked the securitization value against 60% of KMC's entire low cost housing portfolio value. However, the total value that may be securitised could be higher depending on the decision of the KMC and the Baiterek.

Asset Backed



The Nurly Zher programme alone accounts for 69% of the KMC's entire portfolio. However, the total value that may be securitised could be higher depending on the decision of the KMC and the Baiterek⁶⁷.

JSC Mining Corporation Tau-Ken Samruk ("TKS")

The TKS is a national mining corporation in the field of mineral exploration and refinement. It is 100% owned by the Samruk Kazyna, the sovereign wealth fund. The focus areas are gold, copper and lead-zinc deposits.

TKS's Current Projects:

- Tau-Ken Altyn
- Gold and silver refining;
- Current production: 22.7 tonnes a year; and
- Design capacity: Gold 25 tonnes a year, Silver 50 tonnes a year.

- Tau-Ken Temir

⁶⁷ "Further amount of investments into the Nurly Zher Program by the government has been reported to be up to 2,044.8 billion KZT (US\$ 5.313 billion) in 2017-2018" KazInform, (January 8, 2019) Nurly Zher Housing Program results for 2017-2018, retrieved from https://lenta.inform.kz/en/nurly-zher-housing-program-results-for-2017-2018_a3486120

- Metallurgical silicon;
- Current production: 21,000 tons per year; and
- Design capacity: 23,900 tonnes a year.

TKS's Future Projects include:

- Alaigyr mining and refining complex (active construction stage, expected completion date: 2020);
- Shalkiya zinc mining and production facility (construction to start 2019);
- Masalkoye mine (iron, currently seeking partner);
- Northern Katpar mine (tungsten);
- Upper Kairaktinskoye mine (tungsten); and
- Various other gold exploration and possible mining projects.

The current Alaigyr and Shalkiya mining and refining complexes were financed via loans from EBRD. However, TKS's CEO Sanat Kudaibergen, in an interview on 4th May 2019 with the London Post stated that these projects are ready to be carried out with reserved money but they are searching for strategic partners to share financing risks⁶⁸.

Thus, we believe that the TKS is a viable option for an SOE's participation into Islamic finance as an alternative financing source for its operations for the following reasons:

- The nature of its assets being fixed assets (mining fields and adjacent facility) suitable for Islamic finance;
- Over reliance on EBRD loans which has lengthy tender procedures and does not fit the TKS's new development strategy; and
- The need to attract more partners in line with the aim of spreading/sharing the financial risk given the capacity of its projects.

Proposed Simulated Initiative

Our chosen proposition on analysing TKS's projects is the securitization of the Alaigyr and Shalkiya mine projects via an energy *Sukuk* under either *musharakah*, *ijarah*, *murabahah* or even an *istisna Sukuk* structure.

The data on the value of the two mines are as follows:

Alaigyr Mine ^{69 70}	Shalkiya Mine ⁷¹
<ol style="list-style-type: none"> 1. Funding yet to be finalised, current capex estimated between US\$177 million (Tau-Ken Samruk estimate) and US\$238.5 million. 2. Design capacity of lead concentrates: 60 ktpa. 3. Market price for lead produced: US\$2043.00 per tonne. 4. Estimated production value per year: US\$122.580 million. 	<ol style="list-style-type: none"> 1. Current capex estimated US\$350 million. 2. Design capacity (per kpta): <ul style="list-style-type: none"> ▪ high-grade Zinc concentrates: 190ktpa to 230ktpa (wet mass); and ▪ Lead concentrates: 35ktpa to 65ktpa (wet mass). 3. Market Price: <ul style="list-style-type: none"> ▪ LME zinc: US\$2262.00 per tonne; and ▪ LME lead: US\$2043.00 per tonne. 4. Estimated production value per year:

⁶⁸ Dr S. Qureshi The London Post, Kazakhstan – "Tau-Ken Samruk is open for foreign investors – Kanat Kudaibergen", May 4, 2019. Retrieved from <http://thelondonpost.net/kazakhstan-tau-ken-samruk-open-foreign-investors-kanat-kudaibergen/>

⁶⁹ "Production and Processing of Polymetallic Ores at Alaigyr Deposit: Karagandy Region Report", Tau-Ken Samruk Retrieved from <http://tkz.kz/en/investmentproject/alaigyr-mestorozhdenie-svintsai-serebra-v-kazahstane>.

⁷⁰ "KPSP Portfolio: Alaigyr Polymetallic Ore Mining and Processing Plant", KPSP Design Institute, 2014. Retrieved from <https://kpspkz/en/content/alaigyr-polymetallic-ore-mining-and-processing-plant>

⁷¹ "Industrial Development of Polymetallic Ore at Shalkiya Deposit in Kyzylorda Region with Processing Plant Construction", Tau-Ken Samruk. Retrieved from <https://tkz.kz/en/investmentproject/promishlennaya-razrabotka-polimetallicheskih-rud-mestorozhdeniya-shalkiya-v-kizilordinskoi-oblasti-so-stroitelstvom-obogatitelnoi-fabriki>.

- Zinc production: US\$429.78 million to US\$520.26 million; and
- Lead production: US\$71.505 million to US\$132.795 million.

**kpta: kilotonnes per annum; market prices are estimated as per cash rate at the London Metal Exchange price at the date of 21 September 2019.*

Based on the above data, at capex value for the construction of the Alaigyr mine, TKS would be able to issue at least a KZT90 billion *Sukuk*. Additionally, at capex value of the Shalkiya mine, TKS can issue approximately KZT135 billion *Sukuk* to refinance/cover the costs. The total *Sukuk* issuance at capex value of both mines can amount to approximately KZT225 billion.

Our chosen *Sukuk* structure is a *Sukuk musharakah* which may be structured as follows:



The TKS should consider the issuance of similar *Sukuks* to finance its future projects. Subject to the introduction of a Shari’ah index at the KaSE, it is proposed that the TKS list their shares as Shari’ah compliant shares for added value proposition to prospective investors and partners.

DAMU

DAMU was established more than 20 years ago with the mission to play an active role in the sustainable development of MSMEs in Kazakhstan through the implementation of complex and effective support mechanisms.

DAMU operates in every region of Kazakhstan through a network of 16 branches in all regions, 18 “Entrepreneur Service Centres” and 14 mobile business support centres. DAMU provides a wide range of products and services for entrepreneurs such as third party lending, subsidization of loans, loan guarantees, consultation, providing information and analytical materials including a ‘Distance Learning’ programme which in 2018 reached out to 5,635 participants⁷².

Proposed Simulated Initiative

On 14th December 2018, DAMU placed bonds of KZT16 billion at KaSE with a maturity of 13 months with a coupon yield of 8.7%. DAMU had fully redeemed the bonds on June 2019 ahead of schedule. This is in comparison to 2017 where DAMU did not place any securities on the capital market. DAMU has indicated a willingness to continue experimenting with securities placement.

⁷² “Annual Report 2018”, *Entrepreneurship Development Fund DAMU*.

Given DAMU's strong performance, perhaps the next securities placement by DAMU is a *Sukuk* placement on the AIX for the same amount. While there is currently no benchmark based on the KaSE list of corporate securities, yield rates for similar sized bonds are around the same rate. While *Sukuk* is considered new and may bring Shari'ah risks, a plain vanilla *Sukuk* structure of either *murabahah* or *ijarah* should be appropriate to dispel such fears and DAMU may also list the *Sukuk* on AIX and Bursa Malaysia for benchmarking.

Monies from the *Sukuk* issuance can flow into DAMU's new line of activities directed towards the introduction of Islamic finance in Kazakhstan. DAMU is currently attracting funds from the ICD in the amount of US\$40 million that is to be channelled to SMEs via Islamic instruments. This would double the pool size of DAMU's Islamic finance initiative.

In 2018, Moody's Investors Service international rating agency affirmed DAMU Entrepreneurship Development Fund JSC's long-term and short-term rating in the foreign and national currency at Baa3. At the same time, Moody's affirmed the fund's national rating at Aa1.kz. The rating outlook remains stable⁷³.

Our simulated initiative aim to increase DAMU's financial support via Islamic instruments. Under the ICD-DAMU Islamic fund partnership, Islamic instruments would make up around 5.66% of DAMU's total portfolio. A boost in fund from the *Sukuk* will allow DAMU to increase the potential portfolio allocation to 11.5%.

Moving forward for DAMU, there ought to be an incremental increase in both usage of Islamic securities as a means of funding and in terms of instruments in its portfolio. This may be difficult as DAMU's main funding sources have been favourable loans from Baiterek (its parent), ADB, municipal authorities (with interests of only 0.1%), Samruk-Kazyna NWF JSC and the Ministry of Finance.

However, DAMU is keen to introduce and expand Islamic finance as one of its key financing activities. We propose as follows:

- To convert up to 20% of its financing activities into Islamic financing instruments; and
- To convert its loan guarantee scheme into a *kafalah* scheme similar to the Majlis Amanah Rakyat (MARA) *Kafalah* Programme in Malaysia for entrepreneurs.

DBK

The DBK was established as a closed JSC under the Civil Code of the Republic of Kazakhstan in 2001. The DBK has a special legal status and a good track record of budgetary funding and capital injections by the government and the Baiterek (its parent company). The DBK is fully owned by the Kazakhstan government via the Baiterek, a financial arm of the government which uses the DBK to provide financial support to the economy's non-oil sectors.

The DBK focuses its lending activities onto green production and resource-efficient projects. In 2018, the DBK support enterprises initiative has led to the creation of more than 1500 jobs.

Proposed Simulated Initiative

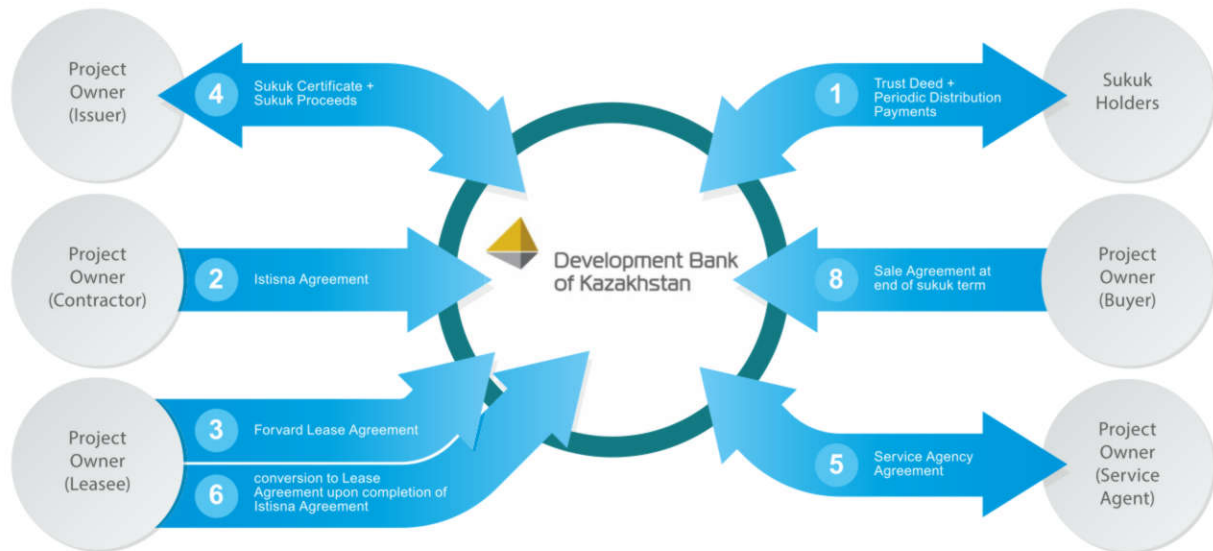
We believe that the DBK should attempt to issue a second *Sukuk* with a focus on green energy development within Kazakhstan. This proposed *Sukuk* can be packaged as an Islamic medium-term notes programme under the principles of *istisna'* and *ijarah* of up to KZT40 billion in nominal value to finance renewable energy projects in Kazakhstan such as solar energy farms.

KaSE's benchmark on medium term Eurobonds issued by the government has an average yield rate of 6.29%. The proposed *Sukuk* could yield to the same rate (or possibly lower) since Kazakhstan currently does not have a sovereign *Sukuk* benchmark. While the DBK had initially mentioned costing as its main concern in issuing *Sukuk* over Eurobonds, we proposed that the yield cost for the issuance of *Sukuk* can be lessened if the DBK

⁷³ *ibid*

issued an SRI green *Sukuk*. The premium placed on the issuance due to Shari'ah compliance concerns should also lessen as the DBK has issued a *Sukuk* before.

Our proposed *Sukuk* structure is as follows:



Under this structure, the liquidity of DBK's *Sukuk* issuance will be placed within a fund (under the control of the DBK as *Sukuk* trustee) that will then focus on disbursing the *Sukuk* funds to green energy projects development within Kazakhstan via *istisna'* contracts. We envisioned that this structure may be replicated by the DBK for a similar *halal* SME fund that will focus on the development of Kazakhstan's *halal* sector, an industry that currently holds approximately more than US\$3 billion in potential value.

Summary of Simulated Initiatives

Our proposed initiatives will serve as the building blocks of increasing Islamic financial assets compared to the total financial assets within Kazakhstan which currently stands at only 0.228% (KZT57.446 billion (as at August 2019)).

In total our simulated initiatives from KMC (KZT100 billion), TKS (KZT225 billion), DAMU (KZT30 billion), and DBK (KZT40 billion) will increase the current level of Islamic financial assets to an approximate value of KZT454.446 billion. This alone is an estimated 791% increase of current levels of Islamic finance assets and 1.8% of total financial assets in Kazakhstan.

ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Finance Institution
ACIF	AIFC Advisory Council on Islamic Finance
ADB	Asian Development Bank
ADIF	Association of Development of Islamic Finance
AFSA	Astana Financial Services Authority
AHIK	Association of Halal Industry Kazakhstan
AI	Artificial Intelligence
AIFC	Astana International Financial Centre
<i>Al-Hilal</i>	Al-Hilal Islamic Bank JSC
<i>Al-Saqr</i>	JSC Al-Saqr Finance
AMFOK	Association of Microfinance Organizations
ARDFM	Agency for Regulation and Development of Financial Markets
<i>Atameken</i>	National Chamber of Entrepreneurs of Kazakhstan " <i>Atameken</i> "
AUM	Asset Under Management
<i>Baiterek</i>	<i>Baiterek</i> National Management Holding JSC
BCBS	Basel Committee for Banking Supervision
BCPD	Bureau for Continuing Professional Development AIFC Ltd
BIBF	Bahrain Institute of Banking and Finance
BSCEE	Banking Supervisors from Central and Eastern Europe
BTA	Bank TuranAlem
CDS	Central Depository System
CIBAFI	General Council for Islamic Banks and Financial Institutions
CIS	Commonwealth of Independent States
CISI	Chartered Institute for Securities and Investment (United Kingdom)
CIT	Corporate Income Tax
CO	Charity Organisation
CPIFR	Core Principles for Islamic Finance Regulation
CSR	Corporate Social Responsibility
CSAB	Central Shari'ah Advisory Board
DAMU	JSC DAMU Entrepreneurship Development Fund
DDL	Decentralized Distributed Ledger
DBK	Development Bank of Kazakhstan
DTA	Double-Taxation Agreement
EAEU	Eurasian Economic Union
EAG/FATF	Eurasian Group on Combating Money Laundering
EBRD	European Bank for Reconstruction and Development
FSTEP	Financial Sector Talent Enrichment Programme (Malaysia)
FinTech	Financial Technology
FGD	Focus Group Discussion
GFHF	Global FinTech Hub Federation
GHG	Greenhouse Gas Emissions
GDP	Gross Domestic Product
GCC	Gulf Cooperation Council
HQC	Halal Quality Centre
HBKU	Hamad Bin Khalifa University

IAC	International Arbitration Centre
IAIS	International Association of Insurance Supervisors
ICBU	International Currency Business Units
ICD	Islamic Corporation for the Development
ICMA	International Islamic Capital Market Association
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IFC	Islamic Finance Centre
IFDI	Islamic Finance Development Indicator
IFI	Islamic Financial Institution
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
INCEIF	International Centre for Education in Islamic Finance (Malaysia)
IOSCO	International Organization of Securities Commissions
IoT	Internet of Things
IPM	Integrated Pest Management
IPO	Initial Public Offering
ISO	International Organization for Standardization
IT	Information Technology
JSC	Joint Stock Company
KaSE	Kazakhstan Stock Exchange
KAZ	Kazakhstan
Kazpost	Kazpost JSC
KazNU	Al-Farabi Kazakh National University
KIC	Kazakhstan Ijara Company JSC
KMC	Kazakhstan Mortgage Company JSC
KMF	Kazakhstan Microfinance
KYR	Kyrgyzstan
KZT	Kazakhstan Tenge
LLCs	Limited Liability Companies
LOLR	Lenders-of-Last-Resort Facilities
MCO	Microcredit Organization
MENA	Middle East and North Africa
MFI	Microfinance Institution
MIFC	Malaysia International Islamic Financial Centre
Ministry of Economy	Ministry of the National Economy
MIFP	Masters in Islamic Finance Practice Programme
MRA	Mutual Recognition Agreement
MSME	Micro, Small and Medium Enterprise
NBK	National Bank of Kazakhstan
NRI	Networked Readiness Index
NPL	Non-Performing Loan
OIC	Organisation of Islamic Cooperation
OMD	Offering, Marketing and Distribution
P2P	Peer-to-Peer
PE	Private Equity
PNB	Permodalan Nasional Berhad
PPP	Public-Private-Partnership
PURCB	Professional Securities Market Participant

QD	Quantitative Development
<i>RegTech</i>	Regulatory Technology
REITs	Real Estate Investment Trusts
ROA	Return on Assets
RUS	Russia
SAMK	Spiritual Administration of Muslims of Kazakhstan
SDG	Sustainable Development Goal
SME	Small Medium Enterprise
SOE	State Owned-Enterprise
SRI	Sustainable and Responsible Investments
STB	Second-Tier Bank
SWF	Sovereign Wealth Fund
TAJ	Tajikistan
TCFD	Taskforce on Climate-related Financial Disclosures
TUR	Turkmenistan
UAE	United Arab Emirates
UAPF	Unified Accumulated Pension Fund
UCITS	Undertakings for the Collective Investment in Transferable Securities
UK	United Kingdom
UN PRI	United Nations-supported Principles for Responsible Investment
UNDP	United Nations Development Programme
UNEP-FI	United Nations Environment Programme – Finance Initiative
USD	United States Dollar
USA	United States of America
UZB	Uzbekistan
VAT	Value Added Tax
VC	Venture Capital
WEF	World Economic Forum

