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IMPLEMENTATION COMPLETION REPORT

KAZAKHSTAN

FINANCIAL SECTOR ADJUSTMENT LOAN

Loan 4051-KZ

June 18, 1998

Private & Financial Sector Development Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS

as of May 31, 1998: Currency Unit - Tenge (T); 1T = US$ 0.0131; US$1 = T 76.65

AVERAGE EXCHANGE RATES

1996	1997	3rd Quarter, 1997	4th Quarter, 1997	January 1998
67.30	75.44	75.55	75.55	76.09

WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
ASF	-	Agricultural Support Fund
BSD	-	Bank Supervision Department
CAS	-	Country Assistance Strategy
CEL	-	Committee for External Loans
CIS	-	Commonwealth of Independent States
EBRD	-	European Bank for Reconstruction and Development
EFF	-	Extended Fund Facility
ETF	-	Economic Transformation Fund
EU	-	European Union
FEDL	-	Finance and Enterprise Development Loan
FSAL	-	Financial Sector Adjustment Loan
FSU	-	Former Soviet Union
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
GOK	-	Government of Kazakhstan
IAS	-	International Accounting Standards
IBRD	-	International Bank for Reconstruction and Development
IBS	-	International Banking Standards
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
JSC	-	Joint Stock Company
MOF	-	Ministry of Finance of the Republic of Kazakhstan
NBK	-	National Bank of the Republic of Kazakhstan
PHRD	-	Policy and Human Resource Development
RB	-	Rehabilitation Bank
SAL	-	Structural Adjustment Loan
SPD	-	State Property Department of the Ministry of Finance
TA	-	Technical Assistance
TAL	-	Technical Assistance Loan
USAID	-	United States Agency for International Development

KAZAKHSTAN'S FISCAL YEAR

January 1 -December 31

Vice President:	Mr. Johannes F. Linn, ECA
Country Director:	Mr. Kiyoshi Kodera, ECC08
Sector Director:	Mr. Lajos Bokros, ECSPF
Program Team Leader:	Mr. Albert Martinez, ECSPF
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IMPLEMENTATION COMPLETION REPORT

KAZAKHSTAN

FINANCIAL SECTOR ADJUSTMENT LOAN NO. 4051-KZ

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MAP
IBRD 29326

IMPLEMENTATION COMPLETION REPORT

KAZAKHSTAN

FINANCIAL SECTOR ADJUSTMENT LOAN

Loan 4051-KZ

Preface

This is the Implementation Completion Report (ICR) for the Financial Sector Adjustment Loan in Kazakhstan, for which Loan 4051-KZ in the amount of US$ 180 million equivalent was approved on June 25, 1996 and made effective on July 31, 1996. The loan was closed on September 30, 1997, six months after the original closing date March 31, 1997. The first tranche in an amount of US$ 90 million released upon effectiveness, was fully disbursed on July 31, 1996. The second tranche of US$ 90 million was disbursed in August 1997.

This ICR was prepared by Lazzat Buranbayeva and reviewed by Fred King (ECC08), Klaus Lorch (ECSPF) and Albert Martinez (ECSPF). This ICR was prepared on the basis of a financial sector review done by Bank's Joint Assessment Mission in February, 1998 and updated by staff in the Resident Mission in May/June 1998. It is based on materials in the project file and discussions held with Borrower staff involved in project implementation. The borrower contributed to preparation of the ICR by its Project Implementation Report (Appendix A).

IMPLEMENTATION COMPLETION REPORT

KAZAKHSTAN

FINANCIAL SECTOR ADJUSTMENT LOAN (4051-KZ)

Evaluation Summary

Introduction.

1. The Financial Sector Adjustment Loan (FSAL) of US$ 180 million was an adjustment operation designed to support the financial sector reform program of the Government and the National Bank of the Republic of Kazakhstan. The Loan was appraised in March 1996, and approved by the Board on June 25, 1996. The Loan Agreement was signed on June 25, 1996, and became effective, with the release of the first tranche of US$ 90 million on July 31, 1996. The second tranche was released on August 6, 1997. The Loan was fully disbursed and closed on September 30, 1997, six months after the original closing date March 31, 1997.

Project Objectives and Design

2. Kazakhstan's reforms were initially implemented against a background of high inflation and sharply declining GDP. In response to these conditions, the Government started in mid-1994 to implement tight monetary and fiscal policies with a package of structural measures aimed at a more rapid and effective restructuring of the enterprise sector, that allowed to achieve some macro-economic and financial stability (Project Implementation Assessment, para. 2). However, sustaining the country's macroeconomic stabilization hinged on banks' ability to force financial discipline on their borrowers, support enterprise adjustment and avoid a systemic banking crisis. Strengthening the financial sector became a key element of the overall program of stabilization and structural reforms in Kazakhstan, and in particular, the continued restructuring and recovery in the enterprise sector.

3. The Government's stabilization policies created favorable macro conditions for the emergence of a sound financial sector, and determined reform policy in the enterprise sector improved conditions for sound bank lending. The FSAL aimed to advance the structural reform process by supporting critical reforms in the financial sector to make it sound and efficient and to ensure a minimum of critical financial services during the transition period. It was developed as an integral part and within the framework of the Bank's and IMF's macroeconomic stabilization programs (PIA, para. 3). Moreover, the Loan also helped to meet external financing requirements and support the budget of the Government.

4. The FSAL program therefore focused on the following two key objectives: (1) improving the sector environment to reduce the operational risks and latent instability of even promising banks; and (2) dealing with old problem loans and problem banks that affected the entire sector.

Implementation Experience and Results

5. The Program supported by FSAL successfully achieved its objectives The Borrower implemented a number of legal and regulatory reforms to establish the appropriate framework for prudent banking. In addition, the Borrower dealt directly with the stock of nonperforming loans and the problem banks. Major portions of nonperforming loans were carved out to special institutions. Nonviable banks were closed, a number of state owned banks were privatized, and banks that were considered too big to fail were restructured with the intent of privatizing them at a later date. The end result of these reforms was that the health of the banking system improved. The balance sheet of the banking sector strengthened. In December 1996 Kazakhstan floated its first Eurobond and became the third country of the former Soviet Union to obtain an international credit rating (speculative). Two Kazakhstani banks - Kazcommertzbank and Halyk Bank - also obtained international credit rating.

6. **Improving the sector environment for a sound banking sector.** The framework for secured lending has been strengthened in several ways. The legal system was developed to provide better security for property rights (PIA, para.8). The institutional development of banks has been fostered in terms of, among other things, better governance through privatization and new bank accounting systems. The number of banks in which the State holds shares has been reduced from 73 in 1996 to 5 in 1998: Halyk Bank, Eximbank Kazakhstan, Zhilstoybank, Central Asian Bank for Cooperation and Development (CABCD - a regional development bank jointly owned with neighboring Kyrgyzstan and Uzbekistan) and Bank Center Credit. All these banks, except CABCD, are in the process of privatization (PIA, para. 9). Inter-bank payments and liquidity management have been facilitated through new monetary and payment instruments and inter-bank payment systems (PIA, para. 10). Progress has also been made in ensuring competition, particularly with regard to the role of the Halyk Bank – the former branch of the Soviet Saving Bank. Growth and strengthening of Kazcommertzbank, Bank TuranAlem and Bank CenterCredit diminished the special position of Halyk Bank in the financial sector and increased competition among the local banks. Easing the entry for the foreign banks contributed to the strengthening of competition in the financial market as well (PIA, para. 11). Prudential supervision has been tightened in a transparent, gradual process. NBK identified 29 banks which will come into compliance with full international banking standards (IBS) by end-1998, and the other banks should achieve IBS by end- 2000. To improve enforcement of the regulations, NBK increased the number of staff in its Banking Supervision Departments and intensified off-site and on-site inspections (PIA, para. 12).

7. **Dealing with problem loans and problem banks.** The financial burden related to old problem loans was shared between bank shareholders and the Government roughly in proportion to their respective responsibility for these loans. The state in many ways relieved banks of bad loans that had been imposed by authorities by transferring the loans to the specially created debt resolution institutes or by transferring them from the banks' accounts to the budget with the banks continuing to service the loans on an agent basis with operational cost compensation. The removal of non-performing loans and isolation of distressed enterprises from the banking system, which minimized the allocation of further resources to them, contributed immensely to the healthy development of the financial system. The non-performing loans made to small and

medium scale enterprises remained in the portfolios of the lending banks, which were urged to establish internal work-out units to deal directly with the problem loans without government assistance (PIA, para. 13). However, the actual resolution of bad loans is still on the agenda of the Government, and in 1998 the Government has adopted a more aggressive approach to resolve this problem (PIA, para. 14).

8. The resolution of problem banks proceeded rapidly on two levels, specifically, the streamlined handling of a large number of ordinary problem banks and the case-by-case treatment of four very large ones. In the mass closure of small and medium problem banks, NBK canceled the licenses of banks which did not meet the prudential norms, including the liquidation of the fourth largest bank (KRAMDS Bank) in September 1996. As a result of closures and mergers, the number of banks decreased from 184 banks in end-1994 to 82 in end-1997. The case-by-case treatment of large problem banks was focused on Turan Bank and Alem Bank (which in 1996 merged into Bank TuranAlem), Agroprom and Eximbank Kazakhstan (PIA, paras. 16-18). The merger of Turan and Alem Banks made necessary the introduction of a waiver of the Loan's second tranche conditions (which originally included separate conditions for each bank). This was approved by the Board on June 23, 1997.

9. **Use of the Foreign Exchange Provided.** The external financing provided by the Loan helped sustain the country's import capacity and provided important budgetary support, especially in view of active measures undertaken by the Government to resolve the problems of arrears on pension and social payments. The specific reform measures introduced under the FSAL allowed the reduction of the risk of a future banking sector crisis which has major budget repercussions, and the enhancement of banks' ability to support adjustment and recovery in the enterprise sector that will have positive effect on the fiscal situation in the longer term.

Summary of Findings, Future Operations, and Key Lessons Learned

10. The project had significant development outcomes. Strengthening of the financial sector increased the country's capacity to implement enterprise sector reform and provided the basis for future economic growth. An improved financial sector better accumulates and allocates financial resources and promotes increased savings. The specific reform measures implemented in the FSAL context have considerably reduced the risk of a future banking sector crisis which has major budget repercussions, and they have enhanced the banks' ability to support adjustment and recovery in the enterprise sector, which is necessary for improving the fiscal situation in the longer term.

11. Future Bank and other donors' operations will use the improved capacity of the banking sector to channel long-term resources to the real sector of the economy. In FY1998 the Bank will start the long-term Agricultural Post Privatization Assistance Project (US$ 85 million, in three phases, over approximately 10 years). EBRD opened a credit line for Small and Medium Size Business Support (US$ 77.7 million). In the future the Bank is not going to provide direct lending to support the development of the financial sector (except the on-going Finance & Enterprise Development Loan), focusing instead on analysis of the financial situation in

Kazakhstan and promoting development of new instruments (e.g. guarantees) as well as providing rapid response TA on an ad hoc basis.

12. The reform program supported by FSAL has yielded important lessons lessons relevant not only to future developments in Kazakhstan but to other transitional economies. These are as follows:

13. **A stable macro-economic framework is critical to the success of financial sector reform.** FSAL was preceded by the Bank's adjustment operations (Rehabilitation Loan of FY94 and Structural Adjustment Loan of FY95) and an IMF stand-by arrangement which provided the macro-economic environment for implementation of the financial sector reform. It is very important that the FSAL was prepared and implemented in parallel with IMF's EFF program, which provided continuing support (through policy advise and conditions, but not funding as Kazakhstan has not withdrawn funds from this facility due to its strong international reserve position) to the macro-economic stabilization program. Close coordination and collaboration with the IMF in preparation of the Bank's FSAL programs was highly desirable as was simultaneous implementation of FSAL and the IMF's programs. FSAL had to follow the program on macro-economic stabilization and not be implemented before such stabilization had started to be demonstrated. Maintaining macro-economic stability was an imperative requirement of FSAL.

14. **Preparation of an FSAL within the framework of a country's medium-term assistance strategy will contribute to the success of the project.** To achieve its development objectives, FSAL was a bridge operation between the macro-stabilization adjustment loans and investment projects to support a sector of economy through provision of resources for on-lending. The former operations create a proper macro-economic environment while the latter ones create incentives for financial sector participants to implement reforms and to get technical assistance.

15. Financial reform strategy implemented in Kazakhstan proved its viability and may provide a useful model for late reforming FSU countries. It includes the following **key elements, which are critical for the development of a sound banking sector:**

A. *Isolation of non-performing enterprises.* Even if debt resolution institutions fail to provide effective restructuring of distressed enterprises, they minimize allocation of further resources to these enterprises, thus contributing significantly to the health of the banking sector.

B. *Burden-sharing concept in resolving problem loans:* Removing those credits that had been explicitly Government directed with a corresponding amount of government/central bank refinancing, letting the banks work out the rest, and giving banks the necessary legal framework and political backing proved to be a better practice than keeping these loans within the banking system for two reasons. First, the indebted enterprises continue to get access to loans from commercial banks. Second, it is unlikely that such enterprises will be forced to undertake restructuring or liquidation.

C. *Policy of gradual easing of access for foreign banks to local market.* Protection of local banks for 2-3 years from intensive foreign competition while pushing them to recover their portfolio losses over that period from local margins and fresh private equity, and easing access for foreign banks once the period is over allowed local banks to strengthen and become competitive. Creating a strong competitive environment once local banks became stronger is critical for further viability and development of local banks.

D. *Dividing banks into two groups - more advanced and less advanced – with appropriate systems of prudential standards.* This approach allowed Government to cope with the initially huge variety in banks' performance through a de facto dual prudential system that created incentives for the better banks to achieve International Banking Standards (IBS) by providing them the access to a wider range of banking operations. At the same time, for weaker banks, such system provided some "grace" period during which they may address their portfolio problems and form necessary provisions, but, at the same time, restricted severely their operations. Over the period these banks either achieved the first group requirements or converted themselves into other vehicles or were closed by the central bank.

16. **Independence of the Central Bank is a key factor in the success of the financial sector reform.** Implementation of the financial reform program involves restrictive and tough measures which usually creates strong opposition at different levels and political pressure to soften the policy. If the Central Bank is dependent on the Government, it is very likely that it will apply different standards to private and state banks, which decreases the effectiveness of introduced measures (prudential standards, banking supervision) and undermine the soundness of the financial system by keeping problem state banks open. In addition, an FSAL should be supplemented by strict monetary policy, which also requires a high level of independence for the Central bank.

17. **Rapid response and timely delivery of TA is very important to support FSAL implementation**. First, as they are developed, TA requirements should be broadly discussed with the Borrower to identify the real benefits of such TA, so they would not be considered as political requirements imposed with adjustment operations, and the Borrower would be interested in receiving this TA. Second, TA projects should have a more flexible structure to address ad hoc needs and/or to adapt to the current situation. Third, TA supporting FSAL operations at the expense of the Borrower, should be provided as much as possible on repayment basis with proper financial models and system of incentives for the ultimate beneficiaries

18. **Hyperinflation, which reduced financial assets and liabilities, and the low level of intermediation by the financial system, gave the government a window of opportunity to build institutions without making major disruptions in the intermediation function**. At the beginning of financial reform in transition economies, banks were mainly providers of financial services. Based on experience in other countries, financial deepening and institution building will take time.

IMPLEMENTATION COMPLETION REPORT

KAZAKHSTAN

FINANCIAL SECTOR ADJUSTMENT LOAN (FSAL)
(Loan No. 4051-KZ)
Part I. Project Implementation Assessment

1. The Financial Sector Adjustment Loan (FSAL) of US$ 180 million was an adjustment operation designed to support the financial sector reform program of the Government and the National Bank of the Republic of Kazakhstan. The Loan was appraised in March 1996, and approved by the Board on June 25, 1996. The Loan Agreement was signed on June 25, 1996, and became effective, with release of the first tranche of US$ 90 million on July 31, 1996. The second tranche was released on August 6, 1997. The Loan was fully disbursed and closed on September 30, 1997, six months after the original closing date March 31, 1997.

A. Project Objectives and Design

2. Kazakhstan's reforms were initially implemented against a background of high inflation and sharply declining GDP. In response to these conditions, the Government started in mid-1994 to implement tight monetary and fiscal policies with a package of structural measures aimed at a more rapid and effective restructuring of the enterprise sector. As the result of these policies, inflation declined sharply from an annual rate of 1,160 percent in 1994 to 61 percent in 1995; the budget deficit was brought down to 3 percent of GDP in 1995 from 6.5 percent in 1994, and the exchange rate of the Tenge was stabilized. Restrictive monetary policy resulted in a deceleration of the broad money expansion to a rate of 98 percent in 1995; and the refinancing rate of the NBK turned positive in real terms in the third quarter of 1994 and has remained so thereafter. The balance of payments improved with a reduction in the current account deficit to 2.5 percent of GDP that led to an increase of foreign reserves to US$1.7 billion by December 1995. The Government liberalized prices and trade, dismantled state-owned holding companies and undertook measures to accelerate privatization. The Government also initiated a policy of accelerated enterprise restructuring in 1995, with support of the SAL. However, sustaining the country's macroeconomic stabilization hinged on banks' ability to force financial discipline on their borrowers, support enterprise adjustment and avoid a systemic banking crisis. Strengthening the financial sector became a key element of the overall program of stabilization and structural reforms in Kazakhstan, and in particular, the continued restructuring and recovery in the enterprise sector.

3. The Government's stabilization policies created favorable macro conditions for the emergence of a sound financial sector, and determined reform policy in the enterprise sector improved conditions for sound bank lending. The FSAL aimed to advance the structural reform process by supporting critical reforms in the financial sector to make it sound and efficient and to ensure a minimum of critical financial services during the transition period. It was developed as an integral part and within the framework of the macroeconomic stabilization program that had been pursued under a Rehabilitation Loan of FY94 and Structural Adjustment Loan (SAL) of FY95, as well as an IMF stand-by arrangement. FSAL was prepared in close coordination with

an Extended Fund Facility Program (EFF) of the IMF which supported the maintenance of the macroeconomic policy framework. Moreover, the Loan also helped to meet external financing requirements and support the budget.

4. The FSAL program therefore focused on the following two key objectives: (1) improving the sector environment to reduce the operational risks and latent instability of even promising banks; and (2) dealing with old problem loans and problem banks that affected the entire sector.

5. In order to establish a conducive environment for sound banking sector growth, the financial sector reform program included the following requirements: (a) strengthening the framework for secured lending; (b) fostering the institutional development of banks; (c) facilitating inter-bank payments and liquidity management; (d) ensuring competition on an even playing field; and (e) tightening prudential supervision. This program supplemented the Government's enterprise reform program which by that time had started to result in the elimination of the least viable enterprises, the restructuring of distressed firms, and the growth of new private enterprises.

6. To resolve problem loans, which in 1995 amounted to about 55-60 percent of the commercial loan portfolio, a burden-sharing concept was accepted, where the reform program relieved banks of bad loans that they had been instructed by various authorities to make, and encouraged the banks' recapitalization from private sources after they had provisioned for the bad loans that had not been imposed by authorities. The financial sector suffered from an overhang not only of problem loans, but also of problem banks. Therefore, the program included components to handle the vast number of smaller problem banks and to focus determined action on the four largest ones: Alem, Turan, Agroprom and Eximbank Kazakhstan.

B. Achievements of Objectives

7. The Program supported by FSAL successfully achieved its objectives The Borrower implemented a number of legal and regulatory reforms to establish the appropriate framework for prudent banking. In addition, the Borrower dealt directly with the stock of nonperforming loans and the problem banks. Major portions of nonperforming loans were carved out to special institutions. Nonviable banks were closed, a number of state owned banks were privatized, and banks that were considered too big to fail were restructured with the intent of privatizing them at a later date. The end result of these reforms is that the health of the banking system improved. The balance sheet of the banking sector strengthened. In December 1996 Kazakhstan floated its first Eurobond and became the third country of the former Soviet Union to obtain an international credit rating (speculative). Two Kazakhstani banks - Kazcommertzbank and Halyk Bank - also obtained international credit rating.

(1) Improving the sector environment for a sound banking sector.

8. The framework for secured lending has been strengthened in several ways. The legal system was developed to provide better security for property rights. The Bankruptcy Law made judicial procedures for bankruptcy cases more speedy and transparent. The Company Law was

recently revised to provide better protection of rights of minority shareholders and to update the company legislation in view of developments in the economic environment. The legislation on mortgages was adopted and a law on pledges on movable property has been submitted to the Parliament, providing the legal basis for secured lending. A new registry system for establishing property rights is being set up, and the procedures for registering collateral have been simplified. A new chart of accounts and a broad set of accounting standards were mandated starting from 1997. A credit information bureau started operations in NBK. The framework for rating agencies has been clarified to avoid conflicts of interest. NBK introduced the rating system for financial status of banks (CAMEL) and already 33 banks were inspected under this system. Moreover, various reforms are under way to modernize and strengthen the judicial system which also will be supported by TA provided under the Bank's FY98 Agricultural Post Privatization Assistance Loan and the Legal Reform Loan planned for FY99.

9. The institutional development of banks has been fostered in terms of, among other things, better governance through privatization and new bank accounting systems. The number of banks in which the State holds shares has been reduced from 73 in 1996 to 5 in 1998: Halyk Bank, Eximbank Kazakhstan, Zhilstroybank, Central Asian Bank for Cooperation and Development (CABCD - a regional development bank jointly owned with neighboring Kyrgyzstan and Uzbekistan) and Bank Center Credit. All these banks, except CABCD, are in the process of privatization. Rehabilitation Bank is being transformed into the Trust Fund. The Budget Bank was closed, transferring its function to the Treasury Department of the Ministry of Finance. A proposed sale of the Eximbank Kazakhstan to Bank Bumiputra Malaysia Berhard and IFC planned for the end of 1997-beginning of 1998 has been jeopardized by the financial crises in East Asia. Currently, the Government in collaboration with IFC is seeking a new strategic investor. In December 1997 Government held tenders for Bank TuranAlem and Zhilstroybank. In both cases the winners were local investors (for Bank Turanalem – a group of Kazakhstani investors, and for Zhilstroybank - Bank Center Credit; for Zhilstroybank the transaction has not been completed yet). The Government approved the program for privatization of the Halyk Bank, which will be implemented by several phases to 2001. As to bank accounting and audit, NBK mandated a new chart of accounts, reporting forms, and accounting standards, mandatory for all banks, as their primary system, and assisted banks, with donor support, in the conversion.

10. Inter-bank payments and liquidity management have been facilitated through new monetary and payment instruments and inter-bank payment systems. For example, an automatic overnight Lombard facility was opened and a Law on Bills of Exchange and Promissory Notes was enacted, conforming with the relevant Geneva Convention of 1930. All banks are now maintaining unified correspondent accounts nationwide with NBK. Payment clearing centers were established in all oblasts, and control over them is being transferred to commercial banks within an improved regulatory framework. For high-value transactions NBK has completed preparations for a special payment system with special standards of security and speed which will be funded under the Finance and Enterprise Development Loan.

11. Progress has also been made in ensuring competition, particularly with regard to the role of the Halyk Bank (former branch of the Soviet Saving Bank). The bank has received operational autonomy and, at the same time, relinquished earlier privileges, such as exemption from reserve

requirements and the free use of local premises. Growth and strengthening of Kazcommertzbank, Bank TuranAlem and Bank CenterCredit, whose assets and branch network are comparable to Halyk's, and which have licenses for household deposits, diminished the special position of Halyk Bank in the financial sector and increased competition among the local banks. Easing the entry for foreign banks contributed to the strengthening of competition in the financial market as well. As of end of the 1997, twenty-two banks (out of 82) were registered with foreign participation. Recently CitiBank and Societe General have opened full operational daughter banks in Kazakhstan. NBK is planning to increase soon the ceiling for aggregate capital of foreign banks to 50 percent (currently the ceiling is 25 percent).

12. Prudential supervision has been tightened in a transparent, gradual process. For example, NBK has clarified the calculation methods of prudential norms developed in accordance with the Basel agreement, enforced a broader range of norms (e.g. including affiliated borrower exposure limits), introduced the classification not only for loans but also for other types of assets and for contingent liabilities, and introduced requirements for provisioning for all the types of classified assets and contingent liabilities. NBK identified 29 banks which will come into compliance with full international banking standards (IBS) by end-1998, and the other banks should achieve IBS by end- 2000. When a bank meets the IBS criteria, it qualifies for the following activities: investment operations, participation in the National Bank credit auctions, conducting international operations; issuing bonds, certificates of deposit, and checks; and acting as custodian in the corporate securities market. These create incentives for banks to strive toward higher prudential performance and limits access of less sound banks to certain operations. To improve enforcement of the regulations, NBK increased the number of staff in its Banking Supervision Departments and intensified off-site and on-site inspections.

(2) Dealing with problem loans and problem banks

13. The financial burden related to old problem loans was shared between bank shareholders and the Government roughly in proportion to their respective responsibility for these loans. The state in many ways relieved banks of bad loans that had been imposed by authorities. The Government in 1995 created two special debt resolution institutions - the Agricultural Support Fund and the Rehabilitation Bank. The Agricultural Support Fund took over from banks non-performing imposed credits to farms. As a result, the loan portfolio of Agroprombank was reduced to US$ 45 million. Forty-six very large industrial enterprises-defaulters, including some that had failed to recover under management contracts, were transferred to the Rehabilitation Bank, and were isolated from the commercial banking system. Nonperforming directed loans made from the Economic Transformation Fund in 1993-1994 were transferred to the Development Bank and the loans made by Alembank Kazakhstan under the export credit facilities in 1993-1994 were transferred to the Eximbank Kazakhstan. After the merger of the Development Bank with Eximbank Kazakhstan and in the course of the strengthening and institutional development of the combined bank, these loans were transferred to the Government, and Eximbank started to service them on an agent basis. The same conversion to managed fund status was done for non-performing imposed loans of Turan Bank (after merger with AlemBank into Bank TuranAlem). Outright recapitalization with budget funds was limited to one bank, Bank TuranAlem. The recapitalization of banks through retained earnings was facilitated by

reforming the tax treatment of loan loss provisions. Injections of new private capital into banks were fostered by enforcing minimum capital and capital adequacy requirements (from December 5, 1997 the minimal capital requirement was T 300 million for newly opened banks and T 100 million for other banks). The removal of non-performing loans and isolation of distressed enterprises from the banking system, minimizing the allocation of further resources to them, contributed immensely to the healthy development of the financial system. The non-performing loans made to small and medium scale enterprises remained in the portfolios of the lending banks, which were urged to establish internal work-out units to deal directly with the problem loans without government assistance.

14. The actual resolution of bad loans is still on the agenda of the Government. Despite quite successful work of the Rehabilitation Bank (a severe reduction in staff of enterprises transferred to the RB – an average 34.3%; liquidation procedures against 4 insolvent enterprises; restructuring of 14 enterprises and privatization and transfer under the management contracts of 26 enterprises), rehabilitation institutions that received the non-performing loans were not able to make much headway in restructuring indebted farms and enterprises due to a number of reasons, and in 1998 the Government adopted a more aggressive approach to resolve this problem. Starting from 1998 the Agricultural Support Fund and the State Property Department of the Ministry of Finance (or the JSC Agency on Reorganization and Liquidation of Insolvent Enterprises authorized by the SPD) were mandated to bankrupt indebted farms and enterprises or provide creditor-led restructuring if the farm or enterprise is potentially viable and has developed a restructuring plan. The Government is also intending to continue the practice of auctioning off bad loans. The JSC Agency on Reorganization and Liquidation of Insolvent Enterprises, which absorbed the Center for Advice to Insolvent Enterprises, has assisted in the preparation of restructuring plans, and has the special mandate from the Government to deal with Government's non-performing loans and debts to the Government on commercial basis (for a commission fee or for a portion of recovered debt). Out of 598 insolvent enterprises included in the scope of the JSC activities, the financial status of 30 enterprises has been improved, 233 have been proposed for liquidation; 57 for sale of state shares; 89 for sanitation, 15 for rehabilitation, 20 for financial rehabilitation, 9 for reorganization, and the remaining enterprises are subject to further analysis.

15. The resolution of problem banks proceeded rapidly on two levels, specifically, the streamlined handling of a large number of ordinary problem banks and the case-by-case treatment of four very large ones. In the mass closure of small and medium problem banks, NBK canceled the licenses of banks which did not meet the prudential norms, including the liquidation of the fourth largest bank (KRAMDS Bank) in September 1996. As a result of closures and mergers, the number of banks decreased from 184 banks in end-1994 to 82 in end-1997. The NBK created special liquidation units in its Banking Supervision Department to oversee the liquidation of nonviable banks. A recent court ruling placed the liquidation process with the judicial system. The case-by-case treatment of large problem banks was focused on Turan, Alem (in 1996 merged into Bank TuranAlem), Agroprom and Eximbank Kazakhstan.

16. Turan Bank went through rigorous restructuring in 1996 under a management team provided by NBK. AlemBank tried to stem the deterioration of its financial condition while the Government negotiated, without success, the bank's privatization to a foreign investor. Based on

audit results that became available in the third quarter of 1996, the bank's capital was more negative than had been estimated, but the Government was reluctant to proceed with liquidation of AlemBank in view of nervousness in the financial markets and among population caused by the closure of KRAMDS bank. In the judgment of NBK, the systemic risk of starting the liquidation of AlemBank would have been unacceptable in this environment. Instead, the Government and NBK decided in December on an alternative course of action, the merger of AlemBank with TuranBank and the subsequent recapitalization and privatization of the resulting TuranAlembank. TuranAlembank was forced to undergo drastic restructuring and downsizing to stabilize its financial situation. Government provided about US$ 90 million to re-capitalize the combined bank and NBK lent to the combined bank about US$ 60 million. In the end of 1997 the Government put the state shares of TuranAlem on tender, and it was purchased by a consortium of local investors. The merger of Turan and Alem Banks made necessary the introduction of a waiver of the Loan's second tranche conditions (which originally included separate conditions for each bank). This was approved by the Board on June 23, 1997.

17. Agroprombank implemented a restructuring plan agreed with NBK. A combination of extensive transfers of bad loans to the Agricultural Support Fund in 1995, enhanced loan collection efforts, tight limits on the bank's new lending activities, and additional restrictions improved the condition of the bank's balance sheet. In the end of 1996 the Government sold back to Agroprombank its entire package of shares in the bank in return for 42 branch buildings which were transferred to the state. With this step, the branch network was downsized, and the bank is now fully privately owned. However, dispersed ownership of Agroprombank is preventing the introduction of a new managerial culture, and the bank still needs to improve its institutional capacity and operations. The achieved financial stability of the bank is fragile and there is a high probability of accumulating non-performing loans from the time when the bank has been allowed to resume active lending operations.

18. Eximbank Kazakhstan was relieved of most of its non-performing loans and their refinancing, and provisioned for the rest in its end-1996 statements. In has since grown cautiously within the constraint of a 3:1 debt/equity ratio, and has focused on a list of core activities and instruments so as to avoid diluting its efforts. While the bank has rejected lending proposed by the authorities at bank risk, such as to the social sector, the bank is sometimes managing state loans on an agency basis. Eximbank implemented a development plan (which was a FSAL second tranche condition) aimed at strengthening its financial position, improved its operational capacities and looked for further privatization. Bank Bumiputra Malaysia Berhad (BBMB) and IFC expressed a strong interest in acquiring 51% of the shares of Eximbank Kazakhstan, but, due to the current financial crisis in East Asia and its impact on Malaysian banks, this transaction has fallen through. The failure of this deal put Eximbank in a difficult financial situation because of lack of expected recapitalization, and affected the overall position of Eximbank in the financial markets. Eximbank does not have its own deposit base for lending (according to the agreed special treatment, it is not allowed to take deposits or keep company and individual accounts until it is privatized), and, due to upcoming privatization, it stopped receiving budget resources for lending activities. The prospects for attracting foreign resources is also uncertain since Kazcommertzbank and Halyk Bank have obtained international credit ratings and it has been widely recognized that Eximbank's liabilities are not backed by the Government.

Eximbank has good institutional capacities and well trained personnel; however, if it is not privatized in the near future, it may lose all its comparative advantages and its niche in the Kazakhstani market.

(3) Use of the Foreign Exchange Provided

19. The external financing provided by the Loan helped sustain the country's import capacity and provided important budgetary support, especially in view of active measures undertaken by the Government to resolve the problems of arrears on pension and social payments. The specific reform measures introduced under the FSAL allowed the reduction of the risk of a future banking sector crisis with major budget repercussions and the enhancement of banks' ability to support adjustment and recovery in the enterprise sector that will have positive effects on the fiscal situation in the longer term.

C. Implementation Record and Major Factors Affecting the Project

20. Implementation of the Financial Sector Reform Policy was satisfactory as discussed above. The following main factors contributed to the successful implementation: (i) the comprehensive macro-economic stabilization policy maintained by the Government and supported by the IMF's EFF arrangements; (ii) strong commitment and independence of the NBK in implementing financial sector reform policy, in close coordination with Government's agencies; (iii) availability of TA to support the program's implementation; (iv) the quality of project design and intensive supervision with active participation of the Borrower.

21. It is necessary to underline, that the Government did not undertake non-desirable actions; this also contributed to the success of the reform program. For example: (i) a deposit guarantee system has not been established, and authorities are not going to introduce it until the banking system has been shaken out dramatically and strengthened, notwithstanding heavy bank lobbying and populist temptations; (ii) since the start of the FSAL no more specialized state banks were established; and (iii) only one bank (Bank TuranAlem) was directly recapitalized with budget funds. These funds were almost entirely used to retire liabilities of the bank rather than to expand assets.

22. There were also factors that negatively affected the project implementation and that created difficulties in achieving some results of the program. The first major factor, which was not in the control of the Bank and the Borrower, was the financial crisis in East Asia in mid-1997. As a result, Eximbank Kazakhstan, whose privatization transaction failed because of this crisis, is still a problem bank. This factor may also have a negative impact on enterprise reform which, in turn, will affect the financial sector, in view of the substantial shareholding and expected investments of East Asian companies in the largest enterprises of Kazakhstan. But the overall negative impact of this factor on sustainability of the financial sector in Kazakhstan is not expected to be very strong. Even if the Government is forced to close Eximbank Kazakhstan for lack of a strategic investor, this will not involve a systemic risk for the banking sector, as the total exposure of the Eximbank is limited and it does not hold company and individual deposits. The loans managed by the Eximbank on agency basis may be easily transferred to the Treasury Department of the Ministry of Finance. Other assets of the Eximbank may be sold. The exposure

of local banks to enterprises with East Asian companies' shareholding is also not very high. In that respect, the possible negative outcome would be the narrowing of good client base of Kazakhstani banks.

23. The results of the program could be even more impressive, if the Government had fully utilized TA provided under the FEDL and TAL. This underutilization of TA to support the program was caused by the lack of interest from beneficiary agencies and, in some cases, vague understanding of the benefits of TA. Latest initiatives on simplification and restructuring of the FEDL with active participation of the Borrower and better understanding by the Borrower of the real needs in financial sector development which could be addressed through TA has allowed a start to overcoming this shortage and providing further implementation and sustainability of the financial sector reform program.

24. The Loan was extended by six months and the release of the second tranche of the Loan was postponed due to the necessity to introduce a waiver to the second tranche conditions as a result of the merger of the Turam and Alem bank as was discussed above in paragraph 16. This was justified by unforeseen circumstances that prevented the authorities from liquidating Alem Bank when their privatization effort failed and the impressive degree of restructuring and downsizing that was achieved in a short time as well as by the firm commitment of the Borrower to privatize TuranAlembank within one year. The waiver was introduced and the second tranche was released under the following conditions: (i) reduction in number of branches, personnel and administrative expenses of the combined bank; (ii) recruiting of new management and introducing a weekly portfolio review system; (iii) removal of the bad loans imposed by the State; (iv) the recapitalization of TuranAlem in an amount of US$ 90 million from the budget; (v) limiting the growth of bank's loan volume (net after the extensive provisioning) to 50% from March 1997 to March 1998 and limiting the exposure to any single borrower to US$ 3 million; and (vi) further privatization of TuranAlembank. The recent privatization of TuranAlembank proved the soundness of this decision.

D. Project Sustainability

25. The comprehensive policy of the Borrower on implementation of the financial sector reform in combination with continued efforts on maintaining macroeconomic stability ensures the sustainability of the program's results. The Borrower continues the implementation of the measures envisaged in the program, using TA provided under the FEDL (development of the payment system, commercial banks institutional development under twinning arrangements, strengthening the institutional capacity of Banking supervision, development of the state property register system and the settlement securities/depository system, and pension reform TA involving banks and non-banking financial institutions). The most serious risk for sustainability of the financial sector is associated with the narrow client base in Kazakhstan which leads to the concentration of lending to a relatively few large borrowers. Currently, the ten largest borrowers accounts for between 30 and 50 percent of lending by the five largest banks. Second, a minor risk is associated with weakness of Agroprombank. The possible problems of this bank would not have a major effect on the health of the overall financial sector, but might create a negative social impact and involve intervention from the NBK. In view of the lack of control over the

management from the numerous shareholders, it is highly desirable to continue work on institutional and managerial strengthening of this bank by concluding the special agreement between NBK and Agroprombank. Special attention is to be paid also to the activities of Halyk bank whose management will be out of the effective control of the small, numerous shareholders and which in coming years will maintain majority of state shares in the bank's capital.

E. The Bank's Performance

26. The Bank's performance proved responsive, flexible and pragmatic as the needs of the time dictated. The Bank, through this project, played an important role in supporting a critical phase of the transition reform program. The policy advice surrounding the design and implementation of this program helped to crystallize Government thinking and the conversion of principles into program and actions. In recognizing the rapidly evolving country situation, the Bank and the Borrower worked collaboratively throughout implementation to ensure that program development objectives were met, while pragmatic solutions to implementation problems were found. The project was supervised at regular intervals and Government was actively involved in discussing the progress made and results achieved. At the same time, the program might have achieved better results with a more rapid response by the Bank in providing TA under the FEDL and in changing the scope of this TA as needed.

F. The Borrower's Performance

27. The Borrower's performance proved its strong commitment to the objectives of the program and its comprehensive policy toward reform implementation. The strong position and independence of the NBK contributed greatly to the success of the project, providing political backing for implementing such measures as closure and merger of weak banks, enforcement of prudential regulations and restructuring of banks as well as restrictive monetary policy. The Borrower's performance was fully satisfactory. However, the better and timely utilization of TA provided by Bank would have helped to achieve even more impressive results, especially in dealing with problem loans and problem banks.

G. Assessment of Outcome

28. The project's outcome was satisfactory, as it achieved its major objectives, created a sound and sustainable financial sector, and provided a basis for future growth of the real sector of the economy. Two major Kazakhstani banks (Kazcommertzbank and Halyk Bank) obtained international credit rating. A number of banks (CenterCredit, Kazcommertzbank, Halyk Bank, Tsesna Bank, Nefte Bank) are participating in twinning programs financed by the EBRD and IBRD. Improving the environment for secured lending has led to increased bank lending activities in the real sector of economy (in 1997 by 20 percent). Savings of individuals in the banking system increased by 48 percent in 1997. Competition in the banking sector is becoming more intense with four major local players (Kazcommertzbank, HalykBank, Bank CenterCredit, TuranAlembank) and active participation of foreign banks. Prudential standards enforced and continually supervised by the NBK are in full compliance with the Basel Agreement and ensure sound operations of the banking system. All major banks are undergoing audits conducted by internationally recognized auditor companies. Isolation of bad loans and non-performing

enterprises prevented further lending to these enterprises and contributed to improvement of the financial position of banks. Now the Government has undertaken decisive measures on debt resolution. The Government achieved very impressive results in privatization of state-owned banks, although it is still having a problem with Eximbank Kazakhstan due to force majeure events, however, measures undertaken in respect to this bank under the program have diminished the risk for the financial system in case of its closure.

29. The project had significant development outcomes. Strengthening of the financial sector increased the country's capacity to implement enterprise sector reform and provided the basis for future economic growth. An improved financial sector better accumulates and allocates financial resources and promotes increased savings. The specific reform measures implemented in the FSAL context have considerably reduced the risk of a future banking sector crisis with major budget repercussions, and they have enhanced the banks' ability to support adjustment and recovery in the enterprise sector, which is necessary for improving the fiscal situation in the longer term.

H. Future Operations

30. Future Bank and other donors' operations will use the improved capacity of the banking sector to channel long-term resources to the real sector of the economy. In FY1998 the Bank will start the long-term Agricultural Post Privatization Assistance Project (US$ 85 million, in three phases, over approximately 10 years). EBRD opened a credit line for Small and Medium Size Business Support (US$ 77.7 million). In the future the Bank is not going to provide direct lending to support the development of the financial sector (except the on-going Finance & Enterprise Development Loan), focusing more on analysis of the financial situation in Kazakhstan and promoting development of new instruments (e.g. guarantees) as well as providing rapid response TA on an ad hoc basis.

I. Key Lessons Learned

31. **A stable macro-economic framework is critical to the success of financial sector reform**. FSAL was preceded by the Bank's adjustment operations (Rehabilitation Loan of FY94 and Structural Adjustment Loan of FY95) and an IMF stand-by arrangement which provided the macro-economic environment for implementation of the financial sector reform. It is very important that the FSAL was prepared and implemented in parallel with IMF's EEF program, which provided continuing support (through policy advise and conditions,but not funding as Kazakhstan has not withdrawn funds from this facility due to its strong international reserve position) to the macro-economic stabilization program. Close coordination and collaboration with the IMF in preparation of the Bank's FSAL programs was highly desirable as was simultaneous implementation of FSAL and the IMF's programs. FSAL had to follow the program on macro-economic stabilization and not be implemented before such stabilization had started to be demonstrated. Maintaining of the macro-economic stability was an imperative requirement of FSAL.

32. **Preparation of an FSAL within the framework of a country's medium-term assistance strategy will contribute to the success of the project.** To achieve its development

objectives, FSAL was a bridge operation between the macro-stabilization adjustment loans and investment projects to support a sector of economy through provision of resources for on-lending. The former operations will create a proper macro-economic environment while the latter ones will create incentives for financial sector participants to implement reforms and to get technical assistance.

33. Financial reform strategy implemented in Kazakhstan proved its viability and may provide a useful model for late reforming FSU countries. It includes the following **key elements, which are critical for the development of a sound banking sector:**

A. *Isolation of non-performing enterprises.* Even if debt resolution institutions fail to provide effective restructuring of distressed enterprises, they minimize allocation of further resources to these enterprises, thus contributing significantly to the health of the banking sector.

B. *Burden-sharing concept in resolving problem loans:* Removing those credits that had been explicitly Government directed with a corresponding amount of government/central bank refinancing and letting the banks work out the rest, and giving banks the necessary legal framework and political backing proved to be a better practice than keeping these loans within the banking system for two reasons. First, the indebted enterprises continue to get access to loans from commercial banks. Second, it is unlikely that such enterprises will be forced to undertake restructuring or liquidation.

C. *Policy of gradual easing of access for foreign banks to local market.* Protection of local banks for 2-3 years from intensive foreign competition while pushing them to recover their portfolio losses over that period from local margins and fresh private equity, and easing access for foreign banks once the period is over allowed local banks to strengthen and become competitive. Creating a strong competitive environment once local banks became stronger is critical for further viability and development of local banks.

D. *Dividing banks into two groups - more advanced and less advanced – with appropriate systems of prudential standards.* This approach allowed Government to cope with the initially huge variety in banks' performance through a de facto dual prudential system that created incentives for the better banks to achieve International Banking Standards (IBS) by providing them the access to a wider range of banking operations. At the same time, for weaker banks, such system provided some "grace" period during which they may address their portfolio problems and form necessary provisions, but, at the same time, restricted severely their operations. Over the period these banks either achieved the first group requirements or converted themselves into other vehicles or were closed by the central bank.

34. **Independence of the Central Bank is a key factor in the success of the financial sector reform.** Implementation of the financial reform program involves restrictive and tough measures which usually creates strong opposition at different levels and political pressure to soften the policy. If the Central Bank is dependent on the Government, it is very likely that it will apply different standards to private and state banks, which decreases the effectiveness of introduced measures (prudential standards, banking supervision) and undermine the soundness of the financial system by keeping problem state banks open. In addition, an FSAL should be

supplemented by strict monetary policy, which also requires a high level of independence for the Central bank.

35. **Rapid response and timely delivery of TA is very important to support FSAL implementation.** First, as they are developed, TA requirements should be broadly discussed with the Borrower to identify the real benefits of such TA, so they would not be considered as political requirements imposed with adjustment operations, and the Borrower would be interested in receiving this TA. Second, TA projects should have a more flexible structure to address ad hoc needs and/or to adapt to the current situation. Third, TA supporting FSAL operations at the expense of the Borrower, should be provided as much as possible on repayment basis with proper financial models and system of incentives for the ultimate beneficiaries.

36. **Hyperinflation, which reduced financial assets and liabilities, and the low level of intermediation by the financial system, gave the government a window of opportunity to build institutions without making major disruptions in the intermediation function.** At the beginning of financial reform in transition economies, banks were mainly providers of financial services. Based on experience in other countries, financial deepening and institution building will take time.

Part II. Statistical Tables

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Note: Tables 6-9 are not applicable for adjustment operations.

Table 1: Summary of Assessments

A. Achievement of Objectives	Substantial (✓)	Partial (✓)	Negligible (✓)	Not applicable (✓)
Macro Policies	✓	☐	☐	☐
Sector Policies	✓	☐	☐	☐
Financial Objectives	✓	☐	☐	☐
Institutional Development	☐	✓	☐	☐
Physical Objectives	☐	☐	☐	✓
Poverty Reduction	☐	☐	☐	✓
Gender Issues	☐	☐	☐	✓
Other Social Objectives	☐	☐	☐	✓
Environmental Objectives	☐	☐	☐	✓
Public Sector Management	✓	☐	☐	☐
Private Sector Development	✓	☐	☐	☐
Other (specify)	☐	☐	☐	☐

B. Project Sustainability	Likely (✓)	Unlikely (✓)	Uncertain (✓)
	✓	☐	☐

C. Bank Performance	Highly Satisfactory (✓)	Satisfactory (✓)	Deficient (✓)
Identification	✓	☐	☐
Preparation Assistance	✓	☐	☐
Appraisal	✓	☐	☐
Supervision	☐	✓	☐

(Continued)

D. Borrower Performance	Highly Satisfactory (✓)	Satisfactory (✓)	Deficient (✓)
Preparation	☐	✓	☐
Implementation	✓	☐	☐
Covenant Compliance	☐	✓	☐
Operation (if applicable)	☐	☐	☐

E. Assessment of Outcome	Highly Satisfactory (✓)	Satisfactory (✓)	Unsatisfactory (✓)	Highly unsatisfactory (✓)
	☐	✓	☐	☐

Table 2: Related Bank Loans

Loan title	Purpose	Year of approval	Status
Preceding operations			
1. TAL No. 3642-KZ Technical Assistance Loan (US$ 38 million)	To provide assistance in the design and development of the Government's reform policies and programs; help build the institutional capacity and skills base to carry out these reforms; initiate policy work for the development of key sectors.	FY1994	On-going
2. REHAB No. 36490-KZ Rehabilitation Loan (US$ 180 million)	At macroeconomic level: to support the program to stabilize the economy; including bringing inflation under control and renewing growth. At the structural level: to support the implementation of policy and institutional reforms intended to promote both an early supply response and the development of a competitive market economy.	FY1994	Completed
3. FEDL No. 3867-KZ Financial & Enterprises Development Loan (US$ 62 million)	Help build institution and infrastructure to carry out enterprise and financial sector restructuring.	FY1995	On-going
4. SAL No. 3900-KZ Structural Adjustment Loan (US$ 180 million)	Facilitate a more rapid and effective restructuring of the enterprise sector – crucial to both macroeconomic stabilization and recovery output, eliminating constraints preventing such restructuring, i. e. liberalizing exports, dismantling monopoly holdings, facilitating entry of firms through land reforms and exit of firms through foreclosure and bankruptcy, accelerating privatization, imposing financial discipline with isolation of distressed enterprises and strengthening unemployment benefit policy to facilitate labor adjustment.	FY95	Completed
Following operations			
1. APPA Agricultural Post Privatization Assistance Loan No. 4331-0-KZ (Program US$ 85 million, first loan US$ 15 million)	Support and development of newly privatized farms and agro-enterprises in key agricultural areas of Kazakhstan and improve rural productivity and incomes.	FY98	Approved by the Board of Directors
2. Pension Reform Loan (US$ 300 million)	To support Government's efforts to finance the transition to a fully funded pension system by providing assistance to help bridge the fiscal deficit resulting from reform of the system.	FY98	Negotiated

Table 3: Project Timetable

Steps in Project Cycle	Date Planned	Date Actual
Identification (Executive Project Summary)	01/15/96	01/15/96
Preparation		02/96
Appraisal	02/01/96	03/02/96
Negotiations	04/08/96	05/29/96
Letter of Development/Sector Policy (if applicable)		05/17/96
Board Presentation	05/28/96	
Signing		06/25/96
Effectiveness	07/25/96	07/31/96
First Tranche Release	06/30/96	07/31/96
Second Tranche Release	12/31/96	08/06/97
Loan Closing	03/31/97	09/30/97

Table 4: Loan Disbursements: Cumulative Estimated and Actual
(US$ thousands)

	FY96	FY97	FY98
Appraisal estimate*	90	90	-
Actual	-	90	90
Actual as % of estimate	0%	100%	-
Date of final disbursement	August 1997		

* Loan Description of the President's Report

Table 5: Key Indicators for Program Implementation
(Policy Matrix)

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
I. PROVIDING AN ENVIRONMENT CONDUCIVE FOR SOUND BANKING SECTOR GROWTH			
a. Strengthening the Framework for Secured Lending			
i. Improving property rights legislation	* Civil Code Part I of early 1995 replaced, inter alia, the laws on property, pledges, and leases. * Draft of Civil Code Part II is being reviewed. * Pres.Decree on Bankruptcy signed in 4/95. * Pres.Decree on Econ. Entities and Companies signed in 5/95. * New Constitution of mid-95 introduced private land ownership. * Pres.Decree on Land signed in 12/95. * **Pres.Decree on Mortgage of Real Estate was signed in 12/95.**	* Prepare legislation on pledges on movable property.	* Substantially met. Law "On Pledges on Movable Property" prepared and submitted to the Mazhilis (Lower Chamber) of the Parliament in January, 1998. Draft Law was sent for review to the World bank before the second tranche release.
ii. Providing information through reporting and registration systems	* New chart of account and several accounting standards for enterprises developed. * Pres.Decree on Accounting issued in 12/95. * Government is publishing lists of delinquent debtor enterprises. * Pres.Decree on Registration of Legal Entities signed in mid-95. * Registration of urban real estate restructured in 1995.	* **Adoption by the Borrower or an Accounting Standards Board of the Borrower, and publication, of a new chart of accounts and a comprehensive set of accounting standards conforming substantially with International Accounting Standards.** * Reduce notary fees on collateral from 10% to a much lower level. * Prepare a registry system for pledges on movable properties. * Start operation of a credit information bureau. * Issue a regulation that prohibits banks and their affiliated parties from owning or managing agencies that rate fin. institutions.	* Met. The new Chart of Accounts was adopted by the Resolution of the National Accounting Commission on November 18, 1996, No. 6 and published in the following magazines: "Information Bulletin of the Ministry of Finance" No.4-5, 1997; "Legal Acts on Finance, Taxes, Accounting and Insurance of the Ministry of Finance of the Republic of Kazakhstan", No.5, 1997; and "Bulletin of an Accounter", No.11, 1997. Introduced accounting standards conform substantially with twenty of the thirty International Accounting Standards (IAS). The new standards are effective from January 1, 1997. * Met. Notary fee on collateral is established as 1% of deal value that is substantially lower than 10%. * Substantially met. Law "On Pledges of Movable Property" which has been submitted to the Parliament contains provisions for registration. Registration system is being establishing under the Ministry of Justice. * Met. Credit Information Bureau of the NBK started its operations in 1997. * Met. Amendments to the Presidential Decree having the force of the Law "On Banks and Banking" enacted on June 11, 1997 establish the list of legal entities in which banks may participate in a capital or in a management (article 8). Rating agencies are not included in the list.

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
iii. Strengthening the judiciary	* Code on Civil Procedures prepared. * Code on *Criminal* Procedure prepared. * Court system unified by abolishing the arbitrage courts in 10/95. * Extensive training program for judicial personnel, including in financial and corporate jurisdiction, developed and started implementation.	* **Pass a law on bankruptcy with adequate provisions for its application and enforcement, or prescribe adequate rules, regulations or procedures for the application and enforcement of the Pres.Decree on Bankruptcy of 1995.** * Introduce a new system of the selection of judges.	* Met. The new Law "On bankruptcy" was adopted on January 21, 1997. The bankruptcy procedures for agriculture are clarified by the Government's Resolution No. 1816 of December 12, 1997. * Met. Reform of judicial system was completed in 1996. Presidential Decree having the force of Law "On courts and status of judges" adopted on February 12, 1995. The re-appointment of judges based on the new system of their selection was completed by the end of 1997.
b. Fostering the Institutional Development of Banks			
i. Enhancing bank governance, especially through bank privatization	* Many banks got partly privatized through privatization of their owners and through share dilution. * MOF swapped the bank shares held by state enterprises against bonds in 3-6/95. The Pres.Decree on Banking of 8/95 forbids such firms to own bank shares. * Turan Bank and Kredsoz Bank, and 8 medium and small banks, fully privatized since mid-95. Licenses withdrawn from 17 banks with state shares. * Strategy for fair and transparent bank privatization has been finalized. * Management of Agroprom and Narodnyi Bank replaced in late 1994, and Alem Bank's in 1/1996. * Government as shareholder agreed to henceforth appoint some independent professionals to the supervisory councils of state-owned banks not slated for privatization in 1996.	* **Offer for sale to private investors all state shares in, or withdraw the banking licenses of, all except no more than 10 banks (other than NBK) whose equity includes state shares.** * Provide in the 1997 budget for potential equity contribution to no banks others than fully state-owned ones.	* Met and surpassed. Government reduced the number of banks with state shares to 5: Halyk Bank, Eximbank Kazakhstan, Zhilstroybank, Central Asian Bank for Reconstruction and Development and Bank CenterCredit. * Met and surpassed. Bank TuranAlem was the only bank recapitalized by the Government (US$ 90 million).
Ii. Transferring modern banking and management skills	* A bank advisory center and two bank training centers started operating in 1994. Two of them were combined under the Bankers Association; the joining of the third is being prepared. * Bank twinning program, with EBRD and IBRD support, for 7 banks has been initiated. Banks are being screened for eligibility, and some grant co-funding has been mobilized. * Withdrawal of over 100 bank licenses since mid-93 has been weeding out ineffective bank managers. * Pres.Decree on Banking of 8/95 tightened the NBK approval of bank and branch managers. * Plan to focus bankers training on priority needs has been developed.		

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
iii. Reforming bank accounting and audit	* New chart of accounts, reporting formats, and accounting instructions for commercial banks developed. * Bank accounting standards based on the International Accounting Standards (IAS 30) established. * In-depth diagnostic studies on the ten largest banks submitted by international auditors in early 1995. * **NBK has issued regulations that make a new chart of accounts, reporting formats and accounting standards mandatory for all commercial banks as their primary system by 1/97, including an opening balance for 1997.** * Implementation of a comprehensive training program in bank accounting commenced.	* Establish bank audit standards. * Introduce standard terms of reference for bank audits and minimum audit disclosure requirements. * Make external audit according to standards equivalent to international ones mandatory for banks on the ISB track, and require it also from large problem banks.	* Met. The Statute "On principal requirements to the audit reports licensed to conduct bank audits (banks' operations) and on types of audit reports" approved by the NBK by its Resolution No. 346 of December 31, 1996 establishes bank audit standards, standard terms of reference for bank audits and minimum audit disclosure requirements. • Met. The Program "On Transition of the second tier Banks to the International banking Standards" adopted in 1996 contains the international audit requirement for banks of the first group. In 1997 Alem Bank and Eximbank Kazakhstan were audited by the international auditors. Currently all large problem banks are undergoing the international audit.
c. Facilitating Inter-Bank Payments and Liquidity Management			
i. Providing monetary instruments to facilitate liquidity management	* T-bills issued through auction since 4/94. Secondary market developed rapidly in 1995. * NBK introduced short-term notes in mid-95. * NBK started repurchase (repo) and reverse repo operations in early 1996. * NBK issued regulations on money market houses. A first one started operating by mid 1995. * Income tax on state securities eliminated. * Lombard facility introduced in early 1996.	* Offer banks with sufficient collateral at NBK an automatic overnight Lombard facility.	* Met. An automatic overnight facilities are available for banks included in the first IBS group.
ii. Broadening the range of available payment instruments	* Republic acceded to the 1930 Geneva Convention on Bills of Exchange and Promissory Notes in 11/95. * Restrictions on the use of cheques revisited in early 1996.	* **Enact a law on bills of exchange and promissory notes conforming with the Geneva Convention of 1930 providing a Uniform Law for Bills of Exchange and Promissory Notes.** * Pass legislation on letters of credit substantially conform with the Paris Convention on Uniform Standards and Procedures.	* Met. Law "On Bills of Exchange and Promissory Notes" conforming with the relevant Geneva Convention of 1930 is enacted. * Met. Operations on letters of credit are subject to the international regulations (Paris Convention). NBK introduced them as mandatory for all banks.
iii. Developing effective and efficient payment systems	* National Payment Council reactivated in early 1995; plays a key role in defining policy and rules. * Improvements to NBK's payments system in 94/95 allow its oblast centers to handle inter-oblast payments via E-Mail. * Almaty Clearing Center, controlled by 9 banks, started up after mid-95. It clears also for others. * Feasibility and design study for a long-term payment system substantially completed.	* Issue improved regulations on inter-bank clearing and on settlement that specify, inter alia, NBK's exclusive supervision responsibilities for payment systems and the requirement that all payments get settled on NBK books. * Elaborate a plan for the transfer of control over clearing operations in the long-term system to the banks. * Require each bank to maintain one unified reserve/corresp. account nationwide with NBK. Exceptions (for technical reasons) require agreement on an implementation timetable. * Start to build a long-term payment system that will channel and settle high-value transactions gross in real time.	* Substantially met. These requirements are covered by the Presidential Decree having the force of a Law "On National Bank of the Republic of Kazakhstan" (1995, later amendments) – see chapter VIII. * Met. NBK approved by its Resolution No. 200 of August 29, 1996 "The Regulations on settlements of interbank payments in the high value system" which address this issue. * Met. As of end of 1997 all the banks except one (International Bank Alma-Ata) are maintaining unified correspondent account with the NBK. * Substantially met. Bidding procedure for long-term payment system in underway.

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
d. Ensuring Competition on an Even Playing Field			
i. Remove regulatory barriers to bank competition	* Over 200 banks were licensed in 1991-93, and 129 are still operating. Licensing requirements have since increased, but licensing has not stopped completely. * Law allows foreign bank ownership up to 100%. More than 12 foreign and joint venture banks exist. * Government Resolution that required each state enterprise to hold its current accounts only in one bank has been abrogated. * NBK is authorized since 1/96 to license foreign-owned banks on a case-by-case basis irrespective of the combined share of all foreign-owned banks in the total capital of all commercial banks.		
ii. Revisit deposit guarantee and deposit insurance	* Pres.Decree on Banking of 8/95 limits the state liability for any bank to its capital in the bank, and thus eliminates the state deposit guarantee. * Among the state banks, only Narodnyi and Housing Bank have licenses for household deposits.	* License a deposit insurance only if it is voluntary and does not implicate NBK or GOK financially.	* Met and surpassed. Deposit insurance system has not been introduces notwithstanding heavy bank lobbying and populist temptation.
iii. Make the savings bank network viable without privileges	* Narodnyi Bank (NB) is free in setting interest rates. * In return, the bank must comply with reserve requirements since 7/95, got its tax freedom repealed, and enjoys no more deposit guarantee. * Management of NB was replaced in late 94. * NB curtailed its commercial lending in 1995, and lent interbank only to banks that it selects among NBK-auction eligible banks. * NB has been reducing fixed costs through staff and branch cuts (having closed 900 outlets since 1993), and raising capacity utilization through new fee-based services and forex deposits. * NB's Supervisory Council has decided to substantially rationalize staffing and to dispose of at least 500 outlets. Government expressed it readiness to authorize the disposal of additional outlets.	* Approve the strategy and restructuring plan for Halyk Bank, incl. the timing of eventual privatization. * Substantially complete the rationalization of Halyk Bank staff and branches. * Instruct state organs to desist from demanding the provision of financial services from Halyk Bank or any other bank without charges that reflect market conditions or costs. * Consider introducing financial incentives to any bank for operating outlets in defined remote settlements a minimum hours per week.	* Met. The strategy and restructuring plan for Halyk Bank was approved by the Resolution of the NBK No. 142 of April 30, 1997. Halyk Bank has obtained managerial and financial autonomy that relieved Halyk bank from provision of any financial services without charges that reflects market conditions. Branch network of the Halyk Bank was drastically downsized with conversion of the branches in the settlement and cashier centers. For example, during 1997-1998 Halyk bank closed 88 branches which involved substantial staff reduction. By its Resolution No. 1051 of June 27, 1997, the Government approved the Program for step-by-step privatization of the Halyk bank for 1997-2000.

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
e. Enforcing Prudential Norms i. Tightening prudential norms and their enforcement	* The main prudential ratios were set at stringent levels in 1994, confirmed in 8/95 by the Pres.Decree on Banking, and further refined by NBK regulations. The calculation of the ratios was clarified by a NBK regulation of 3/96, and their enforcement is being tightened. * NBK regulations clarified the definition of connected borrower and limit the aggregate exposure to all connected borrowers to 100% of capital. * NBK regulation of 3/96 brought guarantees issued by banks fully under prudential supervision. * Minimum capital for commercial banks increased to $0.5m equivalent, $1.5m if a bank has branches or forex transactions, and T 200m (US$ 3m) for banks that take household deposits. * NBK has issued regulations on internal control, internal audit, and credit approval. * Pres. Decrees on NBK and Banking of 1995 reinforced the basis of prudential regulation and enforcement. * NBK raised its staff positions in the Supervision Dept. to 112, in addition to a large bank liquidation unit, and mobilized TA of some 6 person-years per year. It reorganized the Department into teams in charge of clusters of banks, and centralized it in Almaty headquarters. * **A Council of Ministers Decision has confirmed that the state-owned banks are subject to NBK's supervisory norms and enforcement, with any special rules or relaxations of norms that are necessary to take into account the specific nature of their activities to be specifically stipulated by NBK bank by bank.**	* **Issue an NBK regulations implementing the policy regarding an International Standards Bank (ISB) track agreed with the Bank.** Different from a slower base track, the ISB track will lead to full compliance with international standards by end 1998. Only banks on the ISB track will be eligible to special activities such as NBK credit auctions, Government-guaranteed foreign credit, establishment of investment banks, issuance of bank bonds, etc.	* Met. NBK approved on December 12, 1996 a Resolution No. 292 providing for Procedures of Transition of Second Tier Banks to International Standards.

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
II. DEALING WITH PROBLEM LOANS AND PROBLEM BANKS			
a. Sharing the Burden of Problem Loans			
i. Relieving banks of bad loans that had been instructed by authorities	* The Rehabilitation Bank (RB) was created in 1995 to take over the non-performing bank loans and budget claims to very large net debtors. It became fully operational, got more than 30 firms assigned, and has started taking over bank loans to them. * The Agricultural Support Fund (ASF) was set up in 1994, and took over the non-performing instructed farm loans of Agroprom and other banks by mid-95. Agroprom Bank was later also relieved of some bad loans to agro-industrial firms. * The Exim Bank was created in 1994 through spin-off from Alem Bank. By 9/95, it assumed almost all Alem Bank loans funded by export credit agencies against a GOK guarantee; much of this portfolio is non-performing. These loans have been put on a managed fund basis. The 1996 budget includes US$ 320m to repay foreign lenders. * GOK has by end 1994 relieved the commercial banks of the risk associated with Directed Credit of 1994/95, and de facto of loans from an inter-enterprise arrears clearing of early 1994.	* Transfer to the RB some of the insolvent debtors that have been under management contract but still owe overdue credit service to banks. * As to the ASF, ensure substantial MOF representation on its Board; add financial professionals to its staff; produce appropriate financial statements; and internally, separate the post-privatization assistance and subsidy functions, if any, from the debt resolution function. * Convert to managed fund status, or give MOF guarantee for, those non-performing loans of pre-1994 that were clearly instructed by authorities and are still held by commercial banks.	* Met. 44 enterprises were transferred to the rehabilitation Bank. * Substantially met. The new Statute of ASF approved by the Resolution of the Government No. 1590 of November 17, 1997 incorporates these provisions. * Met. The all non-performing loans instructed by the authorities were transferred to the MOF, RB and ASF and banks are servicing loans transferred to the MoF on an agent basis
ii. Requiring and facilitating private recapitalization	* Major increase of minimum capital requirement effective 11/95 forced banks to raise private capital. * NBK introduced in 1995 mandatory loan classification based on a standard methodology, and requires full adequate provisions to be reported since start 1996. (Loan loss provisions can be "amortized" over several years, however, for purposes of calculating capital adequacy.) * **In 12/95, tax provisions have been amended effective from 1/1/1996, to allow, before tax, specific loan loss provisions on all classified loans pre-dating 1995 in full, and up to 50% of the book value of outstanding loans from 1995 or thereafter.** * **An NBK Decision of 3/96 raises the interest rate on reserve/correspondent accounts with NBK to 50% of the NBK's refinancing rate effective 7/1/1996**. Said decision also reduces the reserve ratio to 15% effective 4/1/1996.	* Permit pre-tax specific loss provisions on classified bank guarantees, up to 20% of their value.	* Met. This permission is provided by the "Regulations on classification of bank's assets and contingent liabilities and calculation of provisions for them by second tier banks of the Republic of Kazakhstan" approved by the NBK on May 25, 1997, Res. No. 218 (including amendments approved by the NBK on September 15, 1997, Res. No. 351 and on October 15, 1997, Res. No. 375).

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
b. Resolving Bad Loans			
i. Resolving carved-out bad loans	* A key objective of the Rehabilitation Bank (RB) is to force drastic defensive restructuring or liquidation on large debtor enterprises. An Advisory Unit helps these debtors develop restructuring and liquidation plans. The RB adopted in 2/96 rigorous Operating Principles aimed at ensuring rapid downsizing and cash flow recovery, conditioning funds on implementation benchmarks and phasing it out, encouraging debtor privatization, and using RB funds mainly for downsizing. * The ASF has been asking insolvent farms for restructuring plans, but lacks capacity for farm restructuring on a case-by-case basis. **In 5/96, the Council of Ministers adopted an action plan, satisfactory to the World Bank, on the resolution of loans taken over by the ASF.** The policy focuses on residual debt forgiveness in return for immediate partial payment. * MOF resolution of 2/96 asked all enterprises to repay in one month all principal plus 10% annual interest outstanding to state organs, and offered to forgive all further overdue interest in return. **In 5/96, the Council of Ministers adopted an action plan, satisfactory to the World Bank, on the resolution policy for overdue enterprise borrowing from MOF, or with a MOF guarantee.** It emphasizes the buy-back and sale of loans. * A special GOK commission puts pressure on firms deemed willful defaulters on inherited Exim Bank loans.	* RB will follow its Operating Principles in place since 3/96. * Review the success of the RB in enforcing drastic restructuring and curtailing cash flow losses of its large debtors, and decide an action plan to address weaknesses. * **Initiation of liquidation proceedings against at least 3 insolvent corporate debtors of the RB and reduction of staff of at least 5 other corporate debtors of the RB by 30% each or more in comparison to the numbers employed thereat on 11/1/95.**	* Met. RB followed its operational principles. Credit from the RB were used strictly for downsizing (severance payments or disposal of social assets) and to finance restructuring plans included reduction in staff and negative operating cash flow. Enterprises were privatized when an interested investor has appeared. * Met. RB quarterly reported to the MOF on its activities and utilization of budget resources and agreed on further action plan to be undertaken. * Met and surpassed. As of January 1, 1998, RB pushed the reduction of staff of enterprises by an average 34,3% including 13 enterprises with staff reduction more than 30% and initiated liquidation procedures against 4 insolvent enterprises.
ii. Using state ownership rights to accelerate loan collection	* Government concluded in 1995 management contracts for over 30 major industrial/mining firms. They oblige the contractors to ensure rapid settlement of firms' overdue debt. * Enterprise Restructuring Agency created in 1995 controls the restructuring or liquidation of some small/medium state firms. * Public supplier firms started denying delivery to overdue debtors.	* Review by end 6/96 the model and actual management contracts regarding debt resolution and elaborate better standard provisions. * Review the structure of receivables of the main state-owned utilities, transport/communication, and coal/fuel enterprises; establish a regular reporting of these receivables; and instruct RB, ASF, and Restructuring Agency to coordinate their actions against debtors with them.	* Substantially met. SPD of the MOF (former State Property Committee) reviewed all the existing contracts by the end of 1996. Debt resolution issues were discussed with the management companies. * Substantially met.
iii. Encouraging bad loan resolution by commercial banks	* NBK has been encouraging banks to set up internal work-out units. Turan and Kredsoz Bank receive TA for this. Some large banks are now aggressively pursuing loan resolution. * The phasing in of loan loss provisioning forces banks to emphasize loan collection.		

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
c. Handling Problem Banks			
i. Handling a large number of ordinary problem banks	* Since 6/93, NBK withdrew the licenses of 45% of all banks (103 banks, of which 55 in 1995). * NBK created bank liquidation divisions in 1995. * Pres.Decree on Banking of 8/95 gives NBK effective options for early control of, and proceedings against, problem banks. The Civil Code was amended accordingly. * Since 1995, NBK actively applies graduated sanctions, including early notice, exclusion from credit auctions, time-bound compliance plans, license withdrawal, etc. * NBK issued implementing regulations on bank liquidation in 2/96, and bank conservatorship in 3/96.		
ii. Restructuring and privatizing Alem Bank	* Alem Bank's loans funded by foreign export credit agencies, many of which are non-performing, were moved to the Exim Bank in 1995. * After a crisis in 6/95, Alem Bank's liquidity was restored, and its restructuring initiated, under temporary external management by NBK. * Alem Bank had been privatized spontaneously close to majority, in 1992-94. Private stakes is 47%. * Chief executive was replaced in 1/96. * International audit was carried out in early 1996. * Alem Bank started downsizing by selling assets (fixed assets, investments, and branches), and improving its net worth by stepped-up foreclosure on debtors and collateral. * Alem Bank has been strengthening internal policies regarding, e.g., credit and guarantee approvals, loan/deposit ratio, currency positions, and internal control.	* **Commence negotiations with no more than four private investors for the purchase by them of the majority of shares of Alem Bank.**	* The waiver was introduced before the second tranche release (see table 5-a)
iii. Downsizing Turan Bank	* After partial privatization since 1993, all further state shares in Turan Bank were sold at the exchange in 8/95 to investors around management. * Since mid-95, the bank revised credit procedures, enhanced its loan work-out dept., intensified training, raised paid-in capital, cut its loan/deposit ratio to 1.5, and started improving interest spread and administrative costs. * Loans to over 20 large Turan Bank defaulters are being moved to the RB; loans from the 1994 arrears clearing are included in MOF's loan resolution program; over 20 major debtors came in 1995 under management contracts with debt settlement obligation; and the largest debtor (KARMET) was taken over by a foreign strategic investor. * **NBK and Turan Bank have signed an action plan agreement, satisfactory to the World Bank, aimed at downsizing Turan Bank and bringing it into compliance with NBK prudential norms by end 1998.**	* **Implementation of key elements of the action plan, agreed by IBRD upon FSAL negotiations, pursuant to the agreement between NBK and Turan Bank, or alternatively assumption of NBK conservatorship over Turan Bank.** It will address, *inter alia*, the collection of principal overdue, suspension of lending to large defaulters, loan/deposit ratio, compliance with ISB track capital adequacy, pay-in of private capital, disposal of fixed assets, closure of branches, and the reorganization of the branch network.	* Substantially met. The waiver was introduced before the second tranche release (see table 5-a)

Objectives	Actions Taken before Board Presentation	Actions to be Taken Before Second Tranche	Assessment
iv. Resolving Agroprom Bank	* Agroprom Bank has become 72% private. * Almost all branches ceased lending in early 1994. * Agroprom's directed farm credit moved to ASF in 1995. * Due to the carve-out and negative real interest, Agroprom's portfolio shrank to 5-10% of the 4/94 level. * Since 1/95, Agroprom cut staff by some 28%. * Part of the 1995 grain harvest was pre-financed by another bank, with state guarantees. The pre-financing of the 1996 state grain reserve purchases was tendered among banks. * Regulation on mutual credit societies introduced. * Review of the pros and cons of rural credit cooperatives in the local context commenced.	* NBK to reach agreement with Agroprom on a 3-phase approach: (i) Strongly downsize the branch network, focused on most clearly non-viable or redundant branches; phase out household deposits; (ii) after further study, sell clusters of branches, without restrictions on staff cuts; (iii) limit unsold branches primarily to agency operations or close them. Headquarters might be chosen by the spun-off clusters as a basis for a service center. * If emergency agricultural credit is needed from Government then have it managed on an agency basis by banks or professional fund managers.	* Met. In the beginning of 1996 Agroprombank started implementation of the restructuring plan agreed with NBK. According to the plan, Agroprombank was withdrawn from lending operations for six months. Besides, the plan included requirement of drastic downsizing of the branch network. In the end of 1996 the Government sold back to Agroprombank its entire package of shares in the bank in return for 42 branch buildings which were transferred to the state. * Met. The all Government's agricultural loans were channeled through ASF (post privatization and family farms support) or were lent to the banks under the 100% of risk undertaken by banks and banks' autonomy in selecting agricultural projects to be financed.
v. Putting the Exim Bank on sound footing	* Merger of Exim and Development Bank in 8/95 ended their duplication of term lending. * In-depth audit of Exim Bank carried out. * MOF relieved Exim of all but US$ 14m of its inherited, non-performing externally funded loans by putting them on an agency basis. The bank's assets thus shrank beneath T 7bn before provisioning. * Policy framework for GOK guarantees to foreign lenders has been formulated. Monitoring system for all GOK-guaranteed external loans started up. * Government agreed to put new infrastructure and social sector loans involving Exim Bank, and projects rejected by the bank for lending at its own risk, on an agency basis. * Government agreed to bank's corporatization and partial privatization. * **NBK issued a regulation mandating full compliance by Exim Bank no later than 1/1/97 with NBK's supervisory norms applied to the international standards bank track, except for the connected borrower limit. It limits the debt-equity ratio to 3:1 to account for the particular risks of long-term lending.**	* Complete the institutional diagnostic of Exim Bank. * **Government approval of an institutional development plan, acceptable to the World Bank, for the strengthening of the Exim Bank.** In this context, restrict the bank for 3 years, or until it is substantially privatized, to a specified list of core instrument/activities. * Exim Bank to provision for the inherited ETF loans. Budget to pay in new equity in line with the overall fiscal constraint. * Undertake reasonable efforts to mobilize foreign or other private equity.	* Met. Eximbank undergone the first international audit in 1996 including institutional diagnostic. * Met. Institutional Development Plan of the Eximbank Kazakhstan approved in July 1996 included the all these provisions. * Met. Part of the loans inherited from ETF were transferred to the MoF and put on an agency basis. Residual part was fully provisioned by the end of 1996. * Met. Negotiations on privatization of Eximbank Kazakhstan with Malaysian Bank (BBMB) and IFC were completed. Privatization didn't go through because of unforeseeable events (financial crisis in East Asia).

Table 5A: Waiver of Two Conditions for Release of Second Tranche

Alem Bank was to commence negotiations for its privatization, and Turan Bank was to implement an agreed restructuring plan. Both conditions had been largely fulfilled by late 1996: negotiations for the privatization of Alem Bank had commenced, and satisfactory implementation progress had been made under an agreed restructuring plan for Turan Bank. Subsequently, the negotiations for sale of Alem Bank ground to halt while the bank's financial situations continued deteriorating. The planned fall-back option had been conservatorship and then liquidation of Alem Bank. However, in view of the persistent high anxiety in financial markets and the general public caused by the bankruptcy of another large bank a few months earlier, the National Bank of the Republic of Kazakhstan (NBK) found the systemic risk of this fall-back option unacceptably large at the time. The authorities therefore decided on an alternative course of action. They merged Alem Bank with Turan Bank. They forced the resulting Bank TuranAlem to drastically restructure and particularly to downsize, and provided recapitalization funding to settle liabilities of this bank. The scope and rigor of this restructuring of Bank TuranAlem has in many ways already gone beyond the original restructuring agreement for Turan Bank alone, and continues under NBK's close monitoring. Moreover, in the course of restructuring Bank TuranAlem, its former Alem Bank portion has *de facto* been largely liquidated: All former Alem Bank branches have been closed, all its senior managers released, most of its staff laid-off, most of its liabilities paid off, and the bulk of its loans (which had been non-performing) transferred out of the bank. Moreover, the authorities committed themselves to privatizing Bank TuranAlem no later than by mid-1998. This course of actions, chosen to adapt to changed circumstances but aimed at the Program's sector development objectives, is considered a satisfactory substitute for the actions that were conditions for tranche release. The progress in implementing this revised action plan has been very substantial and rapid.

Table 6: Key Indicators for Project Operation

Not Applicable

Table 7: Studies Included in Project

Not Applicable

Table 8A: Project Costs

Not Applicable

Table 8B: Project Financing

Not Applicable

Table 9: Economic Costs and Benefits

Not Applicable

Table 10: Status of Legal Covenants
Republic of Kazakhstan
Financial Sector Adjustment Loan

Agreement	Section	Covenant Type	Present Status	Description of Covenant
Loan Agreement	3.01 (a,b,c)	9	C	Borrower and the Bank to exchange views on the progress achieved in carrying out the program and on any proposed action taken after loan disbursement that could reverse the program's objectives.
Loan Agreement	3.02 (a,b,c)	1	C	Borrower to have the Deposit Account audited in accordance with appropriate auditing principles by independent auditors acceptable to the Bank; to furnish to the Bank reports of the audit by said auditors within 6 months after the Bank's request for such audit; and to furnish information on the Deposit Account and Audit to the Bank upon such request.

Covenant types:

1. = Accounts/audits
2. = Financial performance/revenue generation from beneficiaries
3. = Flow and utilization of project funds
4. = Counterpart funding
5. = Management aspects of the project or executing agency
6. = Environmental covenants
7. = Involuntary resettlement
8. = Indigenous people
9. = Monitoring, review, and reporting
10. = Project implementation not covered by categories 1-9
11. = Sectoral or cross-sectoral budgetary or other resource allocation
12. = Sectoral or cross-sectoral policy/ regulatory/institutional action
13. = Other

Present Status:

C = covenant complied with
CD = complied with after delay
CP = complied with partially
NC = not complied with

Table 11: Compliance with Operational Manual Statements

Not Applicable

Table 12: Bank Resources: Staff Inputs

Stage of project cycle	Planned		Revised		Actual	
	Weeks	US$	Weeks	US$	Weeks	US$
Preparation to Appraisal	27.5	115.8	37.4	163.8	53.8	247.9
Appraisal	34.0	140.2	21.3	95.6	77.0	75.0
Negotiations through Board approval	22.0	74.6	76.9	60.6	8.6	23.5
Supervision	46.0	179.1	38.3	159.0	45.7	187.8
Completion	0	0	10.0	27.9	0.4	0.8
Total	129.5	509.7	183.9	506.9	185.5	535.0

Table 13: Bank Resources: Missions

Stage of project cycle	Month/ Year	No. of Persons	Days in Field	Specialization[1]	Performance Rating[2] Implem. status	Performance Rating[2] Developm. objectives	Types of Problems[3]
Through Appraisal	5/95	8					
Appraisal through Board approval	2/96	7					
Supervision	10/96	3			S	S	
Completion	12/96	3			S	S	
Total		6					

1 - Key to Specialized staff skills: etc.
2 - Key to Performance Ratings: etc.
3 - Key to Types of Problems: etc.

FINANCIAL SECTOR ADJUSTMENT LOAN
PROJECT IMPLEMENTATION ASSESSMENT

prepared by
THE NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN

1. The financial sector reform program was elaborated by the Government of the Republic of Kazakhstan in collaboration with the National Bank of Kazakhstan (NBK) and its implementation started in the middle of 1995. By that time Kazakhstan's stabilization policies had created favorable macroeconomic conditions necessary for the emergence of a sound financial sector. Strengthening the financial sector was and continued to be a key element of the overall program of stabilization and structural reforms in Kazakhstan, in particular, the continued restructuring and recovery in the enterprise sector.

2. To support the program of financial sector reform, the Government of the Republic of Kazakhstan requested a Financial Sector Adjustment Loan (FSAL) from the World Bank in an amount of US$ 180 million.

Objectives

3. The financial sector reform program of the Government and the NBK addressed two main objectives. First, we wanted to improve the sector environment in order to reduce the operating risks and latent instability of even promising banks. Second, we wanted to deal with old problem loans and problem banks that had been affecting the entire sector.

Results of Program Implementation

Part One: Establishing a Conductive Environment for Sound Banking Sector Growth

4. **Strengthening the Framework for Secured Lending.** The Government paid special attention to the overhauling the property rights legislation. The Constitution of the Republic of Kazakhstan and the Civil Code of the Republic of Kazakhstan (General Part) provided the basis for this legislation and spelled out the recognition of the property rights and their protection (articles 6,18,26 of the Constitution and articles 259-267 of the Civil Code). We have been adopted several laws on specific property rights which provided legal framework for secured lending. This included, for example, a Presidential Decree having the force of the law "On Economic Partnerships" (1995), a Presidential Decree having the force of the law "On Land" (1995) which allowed the use of land as collateral, a Presidential Decree having the force of law "On Mortgage" (1995), and a law "On Bankruptcy" (1997) with a Resolution of the Government specifying the implementation of bankruptcy procedures in agriculture (No. 1816 of 22.12.1997). Recently, the Government submitted to the Parliament the draft law "On Joint Stock Companies"[1] and the draft law "On Pledges on Movable Property". In addition to the legislation, we have begun initiatives that would modernize and strengthen the judicial system to ensure credible and effective resolution of disputes and enforcement of contracts.

[1] Previously, legal provisions for Joint Stock Companies were included in the law "On Economic Partnerships"

5. Security in lending would also be enhanced if an efficient information infrastructure could be established. To this end, a new chart of accounts for enterprises and a comprehensive set of accounting standards conforming substantially with International Accounting Standards was adopted on November 18, 1996 and introduced from January 1997. The establishment of a registration system on borrowers, their real property, their pledges of property and their borrowing was another key condition for enhancing secured lending. Laws and Presidential Decrees having the force of Law "On Mortgage" (1995), "On state Registration of Rights for Immovable Property and Transactions With It" (1995), "On State Registration of Legal Entities" (1995), and Resolution of the Government "On State Code for City Constructions" (1996) provided the legal framework for the registration system, which is being developed with donors' assistance. A credit information bureau started operations in the NBK.

6. **Restructuring the Banking System.** The development of the Kazakhstani banking system in 1995-97 was characterized by consolidation and improvement in the financial condition. The Law "On Amendments to Several Legal Acts of the Republic of Kazakhstan Concerning the Banking Activities Issues" (11.07.1997) made changes in the procedure for liquidation of banks. The Law also removed the classification of banks into investment and deposit banks, and envisaged the expansion of the scope of banking activities. The NBK introduced higher requirements for licensing different banking activities and required banks to install internal procedures and control systems. Today the minimum capital requirement is T 300 million for new banks and T 100 million for existing banks (introduced and made effective on December 5, 1997).

7. As of end-1997, the banking system of Kazakhstan consisted of 82 second tier banks (compared with 101 in 1996) including one intergovernmental bank, five state-owned banks, and 22 banks with foreign participation (including daughter banks). During 1997, four new banks started operations and one bank resumed operations. The Government repurchased shares of Turan Bank and Alem Bank and merged the two banks into the Bank TuranAlem. The Government also repurchased the shares of Kazkredsoc Bank with merged the Bank with the state owned Zhilstroy Bank. These actions were undertaken to reduce instability and systemic risk in banking sector and alleviate the social tension caused by the worsening financial position of Alem Bank and Kazkredsoc Bank, both of which had a large number of deposit-holders. State shares in Zhilstroy Bank and Bank TuranAlem were offered for sale and were eventually acquired by local strategic investors (in case of Bank TuranAlem by consortium of local investors). Kazdor Bank and Caspian bank merged in new Caspian Bank. In 1997 NBK issued and renewed licenses of 55 banks and recalled licenses of 25 banks. Thirteen foreign banks have representative offices in Kazakhstan.

8. To improve the financial stability of banking system by accelerating restructuring of and compliance by banks with the International Banking Standards (IBS), the NBK adopted the Program "On Transition of the Second Tier Banks to the International Banking Standards" (1996). According to the program banks were divided into two groups: first group of banks should achieve the IBS by the end of 1998 and second group by the end of 2000. Each bank should submit to the NBK its "Plan for Recapitalization and Improvement in Operations" by November 15, 1997. NBK recalled the licenses of banks which did not submit plans on time. Improvements in bank governance and banking and management skills are supported by the on-going EBRD and World Bank twining programs.

9. The NBK developed a new chart of accounts, reporting formats and accounting standards for banks conforming with International Accounting Standards (IAS). This chart of account is mandatory for all banks starting from January 1, 1997. The NBK licensed seven auditor companies and six individual auditors to provide audit of banks.

10. **Facilitating Inter-Bank Payments and Liquidity Management.** The Government and the NBK introduced various new monetary instruments that facilitated liquidity management and broadened the range of payments instruments available to banks and enterprises. From April 1996, Government started to issue three month Treasury Bills, from July 1995, six month Treasury Bills, and from July 1996, twelve month Treasury Bills. The Government is preparing the issuance of Treasury Bills with three and five year maturity. From June 1997, the Government started to float medium term promissory notes with two years maturity, and since September 1996, the Government has been issuing National Saving Promissory Notes with one year maturity. In January 1997, the Government converted its debt to the NBK into Special Treasury Bills with maturity of 10 years. The NBK started repurchase (repo) and reverse repo operations with Treasury Bills in early 1996, and introduced short-term NBK notes. Government enacted a Law on Bills of Exchange and Promissory Notes which conform with the relevant Geneva Convention of 1930. Furthermore, NBK has adopted, in agreement with the National Commission on Securities, the uniform requirements for the issuance of shares and promissory notes of banks including the reporting forms. The NBK defined the conditions for banks' participation in share capital of pension funds and companies on pension assets management.

11. There were several initiatives in the development of effective and efficient payment systems. All banks are now maintaining unified correspondent accounts nationwide with NBK. Payment clearing centers were established in all oblasts, and control over them is being transferred to commercial banks within an improved regulatory framework. Currently, the NBK is preparing bidding procedures for the procurement of hardware and software for the payment system under the Financial and Enterprises Development Loan of the World bank.

12. **Ensuring Competition on an Even Playing Field.** As mentioned above, banking system of Kazakhstan in 1997 was composed of 82 banks including 22 banks with foreign shares or foreign daughter banks. Easing the access to the Kazakhstani market for the foreign banks allowed to enhance competition between banks. There are 13 representative offices of the foreign banks including four opened during 1997. Removing special privileges for the Halyk bank (the former saving bank) coupled with strengthening of Kazkommertz Bank and privatization of large Bank TuranAlem and Zhilstroy Bank helped to ensure a strong level of competition among the local banks. The NBK is planning to remove the 25% ceiling for the foreign participation in the consolidated capital of banking system, thereby eliminating a potential regulatory barrier to competition.

13. **Tightening Prudential Supervision.** The prudential regulation of banking activities is provided for in the Regulations "On Prudential Standards" approved by the Board of the NBK on May 23, 1995. The latest amendments to the set of prudential standards introduced requirements for provisioning for all types of classified assets and for contingent liabilities, as well as requirements for provisioning for all types classified assets and contingent liabilities. There are a procedures and a sequence of measures that the NBK can impose on banks violating prudential standards and other requirements. The NBK also introduced mandatory registration of guarantees and other types of contingent liabilities issued by banks. There are

clear procedures for licensing banks for custodial activities and clearly defined conditions of banks' participation in pension funds and assets management companies. In June 1997, the NBK participated in the workshop of the Regional Group of Basle Committee on banking supervision for Caucasus and Central Asian countries devoted to the issues of restructuring in banking system and main principles of banking supervision. Regional Group appointed the representative of the NBK to chair the Group for coming two years.

14. Strengthening the on-site inspection capacities is an important component of the institutional development of banking supervision. The on-site inspection enables NBK to evaluate the financial position of a bank, its managerial capacity, strategy and tactics of a bank's credit policy, and compliance with prudential norms. The NBK is trying to apply the international methods and procedures of on-site inspections, which evaluates the true capitalization level of a bank and assesses the risks associated with a bank's activities. The NBK uses the CAMEL system in rating of the financial position of banks. There were 33 banks inspected using this system. Among them rating 2 (satisfactory) was applied to 14 banks; 3 (less satisfactory) to seven banks; 4 (marginal) to three banks and 5 (unsatisfactory) to nine banks. The rating has not been performed on ten banks as on-site inspection was not provided in full scope. In 1997, the NBK performed 43 on site inspections.

Part Two: Resolving Problem Loans and Problem Banks

15. To resolve problem loans, the Government and the NBK adopted a burden-sharing concept under which the Government relieved the banks of bad loans that had been directed by various authorities, and facilitated (through adequate tax provisions and other means) the banks' recapitalization from private sources after they have provisioned for the bad loans that were not part of the debt relief. The government directed bad loans were transferred to special debt resolution institutions: (1) most loans to some 44 of the country's largest insolvent net debtors were transferred to the Rehabilitation Bank; (2) virtually all non-performing directed loans to farms was transferred to the Agricultural Support Fund (ASF); and (3) all outstanding loans funded by foreign export credit agencies on the basis of government guarantees were transferred to Eximbank Kazakhstan and then transferred to the Ministry of Finance. Eximbank Kazakhstan continued to service these loans on agency principles . After receiving relief from the government directed bad loans, banks were required to make provisions for residual assets and contingent liabilities and to recapitalize themselves through earnings and private capital contributions. Each bank developed a Plan for Recapitalization and Improvement of Operations which laid out a time-schedule as well as the principal measures for financial and operational restructuring.

16. The Rehabilitation Bank received the non-performing loans of 46 large enterprises. These enterprises were isolated from the banking system. During 1995-97, the Rehabilitation Bank pushed for staff reduction of more than 30% in eight enterprises, implemented liquidation procedures on five enterprises, and provided the financing of restructuring in several enterprises. As of January 1,1998, the Rehabilitation Bank serviced 14 enterprises.

17. ASF made continuous efforts to collect non-performing agricultural loans but without substantial success. The Government has mandated the ASF to impose bankruptcy proceedings on nonviable enterprises and develop restructuring plans for potentially viable ones.

18. The resolution of problem banks proceeded rapidly on two levels -- the streamlined handling of a large number of smaller problem banks and the case-by-case treatment of four very large ones. In the mass closure of small and medium problem banks, NBK withdrew licenses of banks which did not meet prudential requirement. For example, in 1997, the NBK withdrew the licenses of 25 banks -- 15 banks for violation of prudential standards; one bank following the decision of the Government of Kazakhstan; two banks following court decisions; one bank following voluntary liquidation; and six banks as result of mergers. As for the large problem banks, all of them were prepared for privatization. The Government almost completed the negotiations with a Malaysian bank (BBMB) and IFC on the privatization of Eximbank Kazakhstan, but, unfortunately, this deal fell through due to the financial crises in East Asia. Zhilstroy Bank and Bank TuranAlem were offered for sale through tender in the end of 1997 and were purchased by local investors. On June 27, 1997, the Government approved the program for step-by-step privatization of Halyk Bank.

Assessments of results

19. The outcome of the program supported by the Financial Sector Adjustment Loan was on the whole quite satisfactory as it achieved all its major objectives. Substantial progress has been made in developing the legal framework for secured lending and for the development of a sound banking sector in Kazakhstan. Strengthening of the financial sector increased the country's capacity to implement enterprise sector reform and provided the basis for future economic growth.

20. The National Bank of Kazakhstan and the Government of Kazakhstan are satisfied with the Bank's performance in the process of implementing the FSAL program. The Bank and the Government have built constructive relations which significantly contributed to the successful outcome of the Program.

Almaty,
Republic of Kazakhstan,
June 5, 1998

International Bank for Reconstruction and Development

FOR OFFICIAL USE ONLY

R97-181

From: Vice President and Secretary

July 24, 1997

KAZAKHSTAN: Financial Sector Adjustment Loan (4051-KZ)
Release of Second Tranche *(Waiver of Two Conditions)*

Attached is a memorandum from the President entitled "Kazakhstan: Financial Sector Adjustment Loan (4051-KZ) - Release of the Second Tranche (Waiver of Two Conditions)".

In the absence of objections (to be communicated to the Vice President and Secretary by the close of business on August 4, 1997), the recommendation contained in paragraph 49 of the memorandum will be deemed approved and so recorded in the minutes of a subsequent meeting of the Executive Directors.

Questions on this documents may be referred to Mr. Klaus Lorch, Task Manager, ECSPF (Extension 37843).

Distribution

Executive Directors and Alternates
President's Executive Committee
Senior Management, Bank, IFC, and MIGA

From: The President July 23, 1997

KAZAKHSTAN: Financial Sector Adjustment Loan (4051-KZ)
Release of the Second Tranche (*Waiver of Two Conditions*)

1. The Board of the Executive Directors approved a Financial Sector Adjustment Loan (FSAL) to the Republic of Kazakhstan on June 25, 1996 to support the reform program in the banking sector. The Loan (US$180 million) was declared effective, and the first tranche of US$90 million was made available, on July 31, 1996.

2. As provided in Section 2.02(d) of the Loan Agreement, a series of discussions has been held in Almaty and Washington to evaluate progress with the sector adjustment program (the Program) and with fulfillment of the conditions for release of the second tranche. The Borrower has shown strong commitment to the Program, and eight of ten conditions for release of the second tranche have been met.

3. The two other conditions for tranche release concern two large problem banks, Alem Bank and Turan Bank. Alem Bank was to commence negotiations for its privatization, and Turan Bank was to implement an agreed restructuring plan. Both conditions had been largely fulfilled by late 1996: Negotiations for the privatization of Alem Bank had commenced, and satisfactory implementation progress had been made under an agreed restructuring plan for Turan Bank. Subsequently, the negotiations for sale of Alem Bank ground to halt while the bank's financial situations continued deteriorating. The planned fall-back option had been conservatorship and then liquidation of Alem Bank. However, in view of the persistent high anxiety in financial markets and the general public caused by the bankruptcy of another large bank a few months earlier, the National Bank of the Republic of Kazakhstan (NBK) found the systemic risk of this fall-back option unacceptably large at the time. The authorities therefore decided on an alternative course of action. They merged Alem Bank with Turan Bank. They forced the resulting Bank TuranAlem to drastically restructure and particularly to downsize, and provided recapitalization funding to settle liabilities of this bank. The scope and rigor of this restructuring of Bank TuranAlem has in many ways already gone beyond the original restructuring agreement for Turan Bank alone, and continues under NBK's close monitoring. Moreover, in the course of restructuring Bank TuranAlem, its former Alem Bank portion has *de facto* been largely liquidated: All former Alem Bank branches have been closed, all its senior managers released, most of its staff laid-off, most of its liabilities paid off, and the bulk of its loans (which had been non-performing) transferred out of the bank. Moreover, the authorities committed themselves to privatizing Bank TuranAlem no later than by mid-1998. This course of actions, chosen to adapt to changed circumstances but aimed at the Program's sector development objectives, is considered a satisfactory substitute for the actions that were conditions for tranche release. The progress in implementing this revised action plan has been very substantial and rapid.

4. This memorandum summarizes the overall progress made under the Program, and reports on the actions taken by the Borrower and NBK to meet the specific conditions for second tranche release. On the basis of the authorities' overall good performance in implementing the Program, putting in place measures that aim at the agreed sector objectives whilst containing risks to the sector's systemic stability, this memorandum seeks a waiver of two conditions and recommends that the second tranche be released.

Vice President:	Mr. Johannes Linn
Country Director:	Mr. Kadir Yurukoglu (acting)
Sector Director:	Mr. Lajos Bokros
Task Team Leader:	Mr. Klaus Lorch

I. BACKGROUND

5. The Financial Sector Adjustment Loan (FSAL) aimed at enabling the financial sector to become sound and efficient, and to ensure a minimum of critical financial services during the transition period. To these ends, the sector reform program was designed to create an environment conducive to sound banking sector growth, and to resolve problem loans and problem banks.

6. The Loan was appraised in May 1996 and approved by the Board on June 25, 1996. The FSAL was signed on June 25, 1996, and declared effective on July 31, 1996. The first tranche was fully disbursed in August 1996.

II. RECENT ECONOMIC DEVELOPMENTS

7. Kazakhstan has been successful in getting inflation under control. Although the increase in the consumer price index was nearly 3,000 percent during 1992, and was still 1,160 percent in 1994, the rate was brought down to 28.6 percent during 1996. The target for 1997 is to limit the increase in the consumer price index to 17 percent during the year. Data available for the first part of this year indicate that inflation is currently running at a rate that would be consistent with the attainment of this target.

8. The current account deficit in the balance of payments reached 9.9 percent of GDP in 1994, but the deficit was reduced to 3.7 percent of GDP in 1996. International reserves (including gold) reached US$2.1 billion at the end of the year, equivalent to 4 months of imports of goods and non-factor services. With imports growing somewhat faster than exports in 1997, the current account deficit is expected to increase this year. However, due in large measure to the inflow of direct foreign investment, the deficit on current account is more than adequately covered by the inflow on capital account. Net foreign exchange reserves are expected to rise by US$234 million during the year. Gross reserves (including gold) are expected to increase to the comfortable equivalent of 4.3 months imports by the end of 1997. The strength of the balance of payments is indicated by the fact that, although Kazakhstan entered into an EFF agreement with the IMF in mid-1996, the authorities have not found it necessary to draw on this facility. It is also suggested by the continuing appreciation of the real exchange rate (by 42 percent in 1995, by 28 percent in 1996, and probably by an additional 5 percent this year).

9. The gains in financial stabilization were brought about as a result of tight fiscal and monetary policies. In real terms, total general government expenditures were cut almost in half between 1993 and 1996. Much of this resulted from the drastic cut in investment expenditures, which were 8.4 percent of GDP in 1993 but had almost disappeared in 1996. A significant build-up in payments arrears (primarily due to delayed payment of pensions and public sector wages) also contributed to holding the budget deficit (which is measured on a cash basis) to 3.1 percent of GDP in 1996. At the end of the year the arrears in government payments exceeded 5 percent of GDP. In 1997 the budget deficit is expected to rise to 4.2 percent of GDP, but half of this cash deficit will be the result of the promised elimination of pension fund arrears by the end of the year. When changes in arrears are taken into account, there will be a substantial further improvement in the budget results in 1997.

10. Money and credit have been kept under tight controls. The supply of broad money is now less than 9.0 percent of GDP. The growth of net domestic credit has been constrained by the increase in international reserves as well as by the limited growth in broad money. Even though government borrowing from the monetary system has been kept under control (and was actually negative in 1996), banking system credit to the rest of the economy has been very tight. Relative to the GDP, credit to the rest of the economy fell from 16.8 percent of GDP at the end of 1994 to only 4.0 percent of GDP at the end of 1996. This tight liquidity has contributed to the growth of inter-enterprise arrears and also to the large arrears in the payment of taxes. To some extent the condoning of payments arrears has served as a substitute for money and credit during this period of very tight liquidity.

11. Real GDP in 1996 was only 60 percent of the level in 1990. Thus the impressive gains in re-establishing financial stability have not been achieved without substantial costs in output and living standards. However, much of the decline in production must be attributed to the breakdown in trade and payments relations with other FSU republics, and to other transitional problems, rather than simply to tight fiscal and monetary policies. Moreover, the production decline now appears to have "bottomed out", and there are modest signs of a recovery in output. GDP grew by about 1.0 percent in 1996 and a modest further improvement of 1.5 percent is projected for 1997. The fact that this year the government will be able to reduce, rather than increase, it own payments arrears is also a hopeful sign. Credit to the rest of the economy, however, remains very tight. At the moment the activities where growth is strongest are those related to the exploitation of Kazakhstan's petroleum and mineral resources, which benefit from a large inflow of direct foreign investment.

III. STATUS OF THE FINANCIAL SECTOR REFORM PROGRAM

12. The Program supported by the FSAL comprises a wide range of actions which, taken together, were designed to enable the financial sector to become sound and efficient, and to ensure a minimum of critical financial services during the transition period. The Program had two principal goals: (a) To improve the sector environment so as to reduce the operating risks and latent instability of all banks; and (b) to resolve old problem loans and problem banks that affected the entire sector. The following paragraphs discuss reform progress in the sector in relation to these goals.

Goal (a): Improving the sector environment for sound banking sector growth

13. The framework for secured lending has been strengthened in several ways. New legislation has been adopted on, *inter alia*, mortgages, companies, and bankruptcy. The latter law has also made judicial procedures for bankruptcy cases more speedy and transparent. New registry systems for different property rights are being established, and the prohibitive notary fees for registering collateral have been revisited. A new chart of accounts and broad set of accounting standards have been mandated with the start of 1997. A credit information bureau has started operations at NBK. The framework for rating agencies has been clarified to avoid conflicts of interest. Moreover, various reforms are under way to modernize and strengthen the judicial system.

14. The institutional development of banks has been fostered in terms of, among other things, better governance through privatization, and new bank accounting systems. The number of banks in with the State holds shares has been reduced in two years from 73 to 11. Among these 11 banks, the State has now on offer its entire stake in four of them, the majority stake in a fifth (Exim Bank) and minority stakes in a sixth (Halyk Savings Bank). A seventh bank (Bank TuranAlem) is being prepared for privatization, and an eighth (Rehabilitation Bank) is slated for closure next year after having completed its mission. The three remaining banks are the housing bank, a regional development bank jointly owned with neighboring republics, and the special-purpose Budget Bank. As to bank accounting and audit, NBK mandated a new chart of accounts, reporting formats, and accounting standards mandatory for all banks as their primary system, and assisted banks with donor support in the conversion.

15. Inter-bank payments and liquidity management have been facilitated through new monetary and payment instruments, and inter-bank payment systems. For example, an automatic overnight Lombard facility has been opened, and a law on bills of exchange and promissory notes has been enacted conforming with the relevant Geneva Convention of 1930. All banks, with only few temporary exceptions for technical reasons, are now maintaining unified correspondent accounts nationwide with NBK. Payment clearing centers have been established in practically every oblast, and control over them is being transferred to commercial banks within an improved regulatory framework. For high-value transactions, NBK has substantially completed preparations for a special payment system with special standards of security and speed.

16. Progress has also been made in ensuring competition on an even playing field, particularly with regard to the role of the Halyk Savings Bank (formerly called Narodnyi Bank). In pursuit of a comprehensive

institutional development plan, the bank has been modernizing its skills, systems, culture, image, and product range, especially non-lending services. State agencies have reportedly ceased asking the bank for major services without appropriate compensation. They have also allowed the bank to cut its number of branches and other outlets by almost half (some 2,000 units), and its staff by about one fifth (2,500 persons), in the past two years. The bank is preparing the initial public offering of about 10 percent of its shares at the stock exchange this year, and the offer of shares to the bank's depositors soon thereafter. The ultimate goal in a three-year horizon is majority private ownership. In return for such operational autonomy and private capital, the bank relinquished earlier privileges such as freedom from reserve requirements and the free use of local premises. To overcome shortages of basic banking services in rural communities as the deregulated and gradually privatized Halyk Bank is closing non-profitable rural outlets, the authorities licensed the state postal enterprise with its vast network of counters to handle cash transfers and act as an agent for commercial banks in collecting household deposits.

17. Prudential supervision has been tightened in a transparent gradual process. For example, NBK has been clarifying the calculation methods of prudential norms, focusing enforcement action on a broader range of norms (including, for example, connected borrower exposure limits), paying increasing attention to banks' contingent liabilities, and subjecting also state-owned banks to examinations. Moreover, NBK has started differentiating an international standards bank track, where banks come into compliance with full international standards by end-1998, from a slower base track towards full standards. When a bank meets the criteria of the faster track, it qualifies to undertake certain operations such as issuing bonds, or collecting household deposits beyond the amount of the bank's capital). This approach had several advantages: It harmonizes to some extent the many differentiations between more or less sound banks that NBK had earlier applied to the access to such operations in an ad hoc fashion; it recognizes the still wide differences in performance levels in the infant stage of the financial sector; and it offers incentives to banks to strive towards higher prudential performance.

Goal (b): Resolving problem loans and problem banks

18. The financial burden related to old problem loans has been largely shared between bank shareholders and the Government roughly in proportion to their respective responsibility for these loans. The state has in many ways relieved banks of bad loans that had been instructed by authorities. Non-performing local sub-loans under externally funded credit lines have been almost entirely removed, together with their refinancing, from the balance sheets of commercial banks. Non-performing instructed loans funded from local sources have largely been converted to managed fund status, including loans stemming from the Economic Transformation Fund in 1993-94. Some forty very large defaulters, including some that had failed to recover under management contracts, had been transferred to the state's Rehabilitation Bank. The Agricultural Support Fund had taken over from banks, in 1995, non-performing instructed credit to farms. Outright recapitalization with budget funds was limited to one bank, Bank TuranAlem (see para. 42). The recapitalization of banks through retained earnings has been facilitated by reforming the tax treatment of loan loss provisions. Injections of new private capital into banks were fostered by enforcing minimum capital and capital adequacy requirements.

19. The actual resolution of bad loans has also made substantial progress. The Ministry of Finance has started auctioning off bad loans that it has taken over from banks because these loans had been instructed. The Government has also been using its ownership rights to accelerate loan collection from state-owned enterprises. In this context, it has been carrying out reviews of the management contracts that it has concluded for dozens of firms, and has been encouraging state utility, fuel, and communication enterprises to step up their collection of receivables. Several state institutions have been playing special roles in debt resolution: (a) The Agricultural Support Fund has been pursuing the farm loan resolution strategy agreed upon prior to Board presentation of the FSAL, and has been strengthened institutionally; (b) The Exim Bank has been trying to collect on a large volume of old, externally funded loans on an agency basis; (c) The Enterprise Restructuring Agency has been forming a cadre of trained administrators and liquidators, and has been involved in the bankruptcy of dozens of medium-size firms where the state had shares or credit claims; and (d) The Rehabilitation Bank has substantially been pursuing a set of agreed operating policies in its restructuring and privatizing, or else liquidating, very large insolvent enterprises. Out of forty enterprises assigned to the Rehabilitation Bank, it has been liquidating four and is preparing a fifth case; forced downsizing and other

restructuring, as well as a fair degree of financial control and often external managers, on some twenty firms; and has released the other fifteen firms mostly for privatization or private management contracts. The Rehabilitation Bank has used a substantial part of its funding for severance pay, wage arrears and essential social services of the insolvent firms. It has not funded investments in fixed assets, and is providing funds generally in installments that decline over time. The bank has been agreeing with enterprises on time-bound restructuring plans that generally include cuts in employment by at least 30 percent within a year.

20. The resolution of problem banks proceeded rapidly on two levels, specifically, the streamlined handling of a large number of ordinary problem banks and the case-by-case treatment of four very large problem banks. In a mass closure of small and medium problem banks, NBK cancelled the licenses of 103 banks from mid-93 through mid-96, and continued with additional 30 license withdrawals since then. Of the 97 banks currently operating, 45 have recently been identified as not even meeting the minimum prudential requirements for the slow, base track towards higher banking standards; this points to a large number of further bank closures. The case-by-case treatment of large problem banks has focused on Turan, Alem, Agroprom, and Exim Bank.

21. Turan Bank went through rigorous restructuring in 1996 under a management team provided by NBK. Alem Bank tried to stem the deterioration of its financial condition while the Government negotiated, without success, the bank's privatization to foreign investors. The authorities then chose to merge Alem Bank with Turan Bank, and forced the combined bank to drastically restructure and downsize, so as to stabilize its financial situation, contain risks, and facilitate the bank's privatization over the coming six to twelve months. These developments are elaborated in paragraphs 39-46.

22. Agroprom Bank agreed with NBK on a improvement plan in fall 1996, and has been proceeding with its implementation. A combination of extensive transfers of bad loans to the Agricultural Support Fund in 1995, enhanced loan collection efforts, tight limits on the bank's new lending activities, and additional restrictions have improved the condition of the bank's balance sheet. Progress was initially slower, however, in downsizing the branch network and staffing levels, and thus in reducing expenditures. Late in 1996, however, the Government sold back to Agroprom Bank its entire package of shares in the bank in return for 42 branch buildings being transferred to the state. With this step, the branch network has been downsized, and the bank is now fully privately owned. Moreover, the state earmarked the 42 buildings for lease to emerging rural credit societies.

23. Exim Bank has been relieved of most of its non-performing loans and their refinancing, and provisioned for the rest in its end-1996 statements. It has since grown only cautiously within the constraint of a 3:1 debt/equity ratio, and has focused on a list of core activities and instruments so as to avoid diluting its efforts. Where the bank rejected lending proposed by the authorities at its risk, such as in social sectors, it is sometimes managing state loans on an agency basis. These and other positive developments at the bank are underpinned by a satisfactory development plan, built on the results of an international audit. Negotiations are now under way for a strategic investor and IFC together to acquire the majority of shares in Exim Bank.

IV. PROGRESS AGAINST TRANCHE RELEASE CRITERIA

24. Pursuant to Section 2.02(d) of the Loan Agreement, conditions for the release of the second tranche require that the Bank shall be satisfied with the progress achieved by the Borrower in carrying out the Program, and that the actions described in Schedule 3 to the Loan Agreement have been taken and are satisfactory to the Bank.

25. Progress in carrying out the Program has been strong as described in Section III above. The status of the specific actions provided in the Loan Agreement is described below.

(i) ***Continued maintenance of the macroeconomic policy framework consistent with the objectives of the Program as determined on the basis of indicators satisfactory to the Bank.***

26. This condition has been met. Progress in the macroeconomic sphere is described in Section II above.

(ii) **Adoption by the Borrower or an Accounting Standards Board of the Borrower, and publication, of a new chart of accounts and a comprehensive set of accounting standards conforming substantially with the International Accounting Standards.**

27. This condition has been met. The National Accounting Commission of the Republic of Kazakhstan adopted and published twenty accounting standards through its Resolutions Nos. 3, 4, 5, and 7 dating from November 13 to 21, 1996. The standards are effective from January 1, 1997, except for three standards that will become effective a year later. These standards conform substantially with twenty of the thirty International Accounting Standards (IAS). Together, the new standards constitute an adequately comprehensive set, since the other ten IAS are not yet of significant relevance in the current business environment of Kazakhstan or, in two cases, need to await the promulgation of the Civil Code Part II with regard to provisions on non-tangible assets. An additional standard, for banking institutions, had been approved by NBK Resolution No. 237 of December 26, 1995.

28. The National Accounting Commission also approved a new General Chart of Accounts for business entities, and declared it effective from the beginning of 1997. With about 190 accounts on the third-digit level, the new chart has appropriate detail. The chart of accounts permits the application of the new accounting standards.

29. The new accounting standards and chart of accounts were presented to the public at a national conference on in late November, 1996, widely distributed to professional and educational entities, and published in newspapers in December 1996.

(iii) **Offering for sale to private investor all state shares in, or withdrawing the banking licenses of, all except no more than ten banks (other than NBK) whose equity includes state shares.**

30. This condition has been met. In mid-1995, there were about 73 banks whose shares were owned by the Borrower, or by legal entities majority owned by the Borrower. Of these 73 banks, 32 have by now been fully privatized, and 30 had their license withdrawn. Of the remaining 11 banks with state shares, three (Tsvetmet, Kazkomstroi and BSB) have been offered for sale at the stock exchange, with the minimum prices reduced over time to as little as 1 percent of the net book value of the shares. Another bank, Kazpochta Bank, has been on offer outside the stock exchange since last December.

31. This leaves at present only 7 licensed banks whose state shares have not yet been formally offered for complete sale. The Budget Bank will remain fully state owned. The state's Rehabilitation Bank will be closed after 4 years of existence, i.e., in 1999. The Exim Bank is negotiating with a foreign strategic investor and the IFC, but will leave a minority share in state hands. In the Central Asian Bank for Reconstruction and Development that is jointly owned with neighboring republics, as well as in the Housing Bank, the state will likely retain ownership as well. The privatization of Halyk Savings Bank is being prepared to start this year with the offer of some shares to its household depositors and some further shares to foreign portfolio investors. Bank TuranAlem is undergoing drastic restructuring, and the Government expressed its commitment to privatize it in the first half of 1998.

(iv) **Enactment of a law on bills of exchange and promissory notes conforming with the Geneva Convention of 1930 providing a Uniform Law for Bills of Exchange and Promissory Notes.**

32. This condition has been met. A Law On the Circulation of Bills in the Republic of Kazakhstan was enacted by parliament last April and signed by the President of the Republic on April 28, 1997. The law addressed bills of exchange as well as promissory notes. The law conforms substantially with the 1930 Geneva Convention on Bills of Exchange and Promissory Notes.

33. Article I of the Convention requires parties to the convention to enforce or enact in original texts in their national language a Unified Law as set forth in Appendix I of the Convention. It permits signatory countries to make certain reservations, but requires them to declare, at the moment of ratifying, or acceding to, the Convention which reservations they have elected to make. The Convention became effective in Kazakhstan on August 21, 1995, through Presidential Decree No. 2418 On the Republic of Kazakhstan Becoming a Signatory to the Geneva Convention of June 7, 1930. In the above law, Kazakhstan did elect to reserve a number of rights which are allowed in Appendix II of the Convention and which were included in the list of reserved right of Presidential Decree No. 2418.

(v) Issuance, by NBK, of regulations implementing the policy regarding the international standards banks track agreed with the World Bank.

34. <u>This condition has been met</u>. NBK approved on December 12, 1996 a Resolution No. 292 providing for Procedures of Transition of Second-Tier Banks to International Standards. Resolution No. 292 conforms substantially with the concept agreed between the Borrower and the Bank. Among other things, the Resolution provides for: An international standards track ("Group 1") and a base track ("Group 2") for commercial banks; annual minimum ratios that lead towards full compliance with final prudential standards by end-1998 (Group 1) or end of the year 2000 (Group 2); a requirement of bank improvement plans to underpin the increase in prudential performance; incentives to achieve Group 1 status, including the right to take household deposits to an extent that exceeds the bank's capital; and the expectation of license withdrawal from banks that do not even achieve Group 2 performance levels.

35. By June 1, 1997, NBK finalized its review of all licensed banks. It assigned Group 1 status to 25 banks, and Group 2 status to 27 banks. Since the minimum prudential ratios for both groups will rise over time following the schedule stipulated by Resolution No. 292, these numbers will change. Further 45 licensed banks did not meet the minimum criteria even for Group 2, and are thus excluded from either group; Resolution No. 292 indicated NBK's intention to withdraw licenses from such banks.

(vi) Initiation of liquidation proceedings against at least three insolvent corporate debtors of the Rehabilitation Bank and reduction of staff of at least five other corporate debtors of the Rehabilitation Bank by 30 percent each or more in comparison to the numbers employed thereat on November 1, 1995.

36. <u>This condition has been met</u>. Liquidation has been practically completed for one large enterprise, is well under way for two more, has been legally initiated for a fourth, and is being prepared for a fifth. (a) The closure of Karaganda Liquidschaht with its five coal mines of formerly 1,840 employees is virtually completed. The final steps are the sell-off of some last pieces of installation. Most of the former employees have been laid off, and another third of the employees, mainly those suffering from work-related accidents or sickness, were transferred to other mines. The Rehabilitation Bank is also engaged in the liquidation of two additional coal mines that did not belong to the same enterprise. (b) Phosphochim in Alga, a producer of boric acid with once well over 1,000 employees, was declared bankrupt by an oblast court last November, upon applications by the Rehabilitation Bank as creditor as well as another state agency as owner representative. The liquidation commission has now closed the plant, catalogued assets and creditors, and started the sale of assets. (c) For the Petropavlovsk Small Engines Plant, with formerly 1,320 employees, a general shareholder meeting decided last November the firm's voluntary liquidation. The liquidation commission has offered the assets of the enterprise for sale as essentially a whole in late May 1997, and has recently reduced the minimum price for lack offers. (d) A fourth company, Belogorsky Mining and Concentration Corporation with formerly 1,590 employees, was declared bankrupt by a court last March upon application by the Rehabilitation Bank as creditor. Creditor claims have been filed, and the Creditor's Meeting was held in June. (e) For the Tekeli Lead Zinc enterprise, which once employed about 2,700 persons, the filing of an application for bankruptcy with the courts is under preparation since the authorities cancelled a management contract and transferred the enterprise to the Rehabilitation Bank for liquidation.

37. The conditionality regarding employment reduction is fulfilled as well. Most of the enterprises that were brought under the control of the Rehabilitation Bank had been over-staffed or employed persons in non-viable operations. The 25 enterprises that the Rehabilitation Bank controlled by end-96 had more than 64,000 employees in November 1995. By May 1997, fourteen of these enterprises had cut their employment by more than 30 percent each, ranging from 31 to 75 percent. Four additional enterprises were in liquidation, as explained above. Only seven enterprises had so far reduced their staff by less than 30 percent.

(vii) Approval by the Borrower of a development plan, acceptable to the World Bank, for the institutional strengthening of the Exim Bank.

38. This condition has been met. The Board of Directors of Exim Bank approved an institutional development plan in November 1996. The plan has been signed by each member of the bank's Board, including Deputy Prime Minister and Minister of Finance. The plan is in conformity with the requirements agreed between the Borrower and the Bank. As a high-level document it is strategic, and comprehensive in coverage. A strategy statement and an organization chart are incorporated in its text. Operational details for the shorter term has subsequently been included in a business plan and the 1997 budget of the bank. Further operational detail is also provided in a Memorandum on Credit Policy. Key elements of the institutional development plan are backed up by earlier Government Resolutions and Exim Bank Board decisions. They concern, *inter alia*, the bank's corporatization and privatization; the charter of the bank; the prudential norms applicable to the bank; its relief from non-performing loans and their external refinancing that it inherited from its predecessor institution; and relief from, and future arrangements for, loans that had originated under the state's Economic Transformation Fund.

(viii) Commencement of negotiations with no more than four private investors for the purchase by them of the majority of shares of Alem Bank."

39. This condition had largely been fulfilled. However, confronted with changing circumstances, the Borrower chose to revise its strategy to achieve the same sector development objectives. On this satisfactory alternative course of actions, substantial progress has been achieved. The Alem Bank, the former trade bank of the state and still 53 percent owned by the state in early 1996, has been the country's largest bank by gross assets. After it emerged from a brief conservatorship in 1995 but was still saddled with major governance, management, and portfolio problems, the state offered its shares for sale to investors. By September 1996, the Government with NBK's support had in fact commenced intensive negotiations with a foreign business group for the sale of the state's stake in Alem Bank. This investor was expected to help bring Alem Bank's capital in compliance with capital adequacy requirements and improve liquidity, while the Government would facilitate this by settling various obligations towards Alem Bank and taking over external liabilities that it had guaranteed. By mid-October, 1996, the two negotiating parties were reportedly close to agreement. However, demands of the foreign investor in unrelated areas, as well as indications that contingent liabilities were worse than expected, then led to a slowdown in the negotiations. By December, the negotiations were discontinued.

40. The authorities had been contemplating conservatorship with liquidation as the fall-back option. Based on audit results that became available in the third quarter, the bank's capital had a more highly negative than had been estimated. (A further audit as of end-1996 showed necessary provisions finally amounting to 89 percent of gross loans.) The bank operated on the verge of illiquidity, requiring heavy support by NBK and other state-owned banks. However, in September 1996, Kramds Bank, the fifth largest bank and a major collector of household deposits, went bankrupt. The resulting nervousness in the financial markets, wide publicity, and public protests were slow to subside. In December, when the negotiations for sale of Alem Bank had failed, it was the judgment of NBK that the systemic risk of starting the liquidation of Alem Bank would be unacceptable in this environment, for months to come. In the meantime, Alem Bank would likely deteriorate further through the loss of deposits, good clients, and qualified staff.

41. In this situation, the Government and NBK decided in December on an alternative course of action, namely, the merger of Alem Bank with Turan Bank and the subsequent recapitalization and privatization

of the resulting "Bank TuranAlem". (Turan Bank, as will be explained below, was the privatized former state industrial bank.) Bank TuranAlem would close all former Alem Bank branches, sell their fixed assets, replace all senior Alem Bank managers, settle in court various disputes of former Alem Bank, and extend the rigorous restructuring that had already well advanced in Turan Bank to the Alem portion of TuranAlem's balance sheet. The state budget would provide for the recapitalization of Bank TuranAlem, but these funds would be used generally to repay liabilities and not to provide liquidity for new lending. This would curtail additional portfolio risks, generally make the bank less "too-large-to-fail", and increase the prospects for Bank TuranAlem's privatization, which would be the final objective anticipated no later than mid-1998.

42. The Bank thereupon agreed with the Borrower on a set of actions, plans, and commitments to ensure that, first, the objectives of the Program would be supported and, second, the privatization objective (originally relating to Alem Bank) and the restructuring objective (originally relating to Turan Bank, as explained below) would ultimately be achieved. By now, the authorities in collaboration with Bank TuranAlem have met all the prior actions, submitted a satisfactory restructuring agreement between Bank TuranAlem and NBK, and provided all the formal commitments that had been agreed upon. These steps can be summarized as follows:

(a) The former branches of the Alem Bank and Turan Bank have been reduced within one year from 103 to 27, i.e., by three quarters: 17 of the branches were closed before merger and 39 after the merger, and 24 branches had their licenses withdrawn and operate now as mere cash windows for nearby branches. The duplication of branches in any one town has been eliminated. Vacated office buildings have been put on sale. For the bank's largest fixed asset, a very large new office tower in Almaty, the bank has substantially completed its sales negotiations with a buyer; only outstanding are issues of taxation that the buyer is negotiating with the authorities. Staff of the two original banks has been reduced from a combined total of 4,600 in mid-1996 to about 3,600 by end-1996, and further to less than 2,100 persons since the merger. The bank also agreed with NBK to cut its administrative expenses by 28 percent in 1997.

(b) The bank's chairman and deputy chairmen were all recruited from outside the two original banks. This new management team has been demonstrating substantial professional competence. The majority of department directors and many branch directors were replaced as well. Major progress has been made in strengthening headquarters control of branches and centralizing credit decisions; all branches now report directly to headquarters. The combination of the accounting systems of the two original banks has advanced well, and the Republic's new chart of account for banks is being adopted. A weekly portfolio review system is being introduced.

(c) Practically all external liabilities inherited by Bank TuranAlem that had been guaranteed to the foreign parties by the State, and whose on-lending had been directed and has been non-performing, have been assumed by the State. The corresponding local loans have been removed from the bank's balance sheet. From among the bank's other loans, 80 percent (US$80 million equivalent, by gross value) of those that were classified as "loss" by an international audit have been removed from the legal ownership and balance sheet of the bank. For a large part of these removed loans, Bank TuranAlem will act as a collection agent on behalf of the new creditors. In addition, the bank has ceased lending to defaulters. Furthermore, the bank agreed with NBK to offset deposits of defaulters with their credits, and to collect by end-1997 30 percent on its doubtful loans and 50 percent on its substandard loans.

(d) The State has provided a total of approximately US$150 million equivalent for the recapitalization of Bank TuranAlem. The vast majority of these funds have been used to repay liabilities of the bank, and thus to downsize it financially. Firstly, US$30 million was provided in January upon the merger by converting into equity the Government's deposits that dated back to its efforts to stabilize Alem Bank and Turan Bank. Secondly, an additional US$60 million was paid in April, and has by now almost entirely been utilized to repay liabilities of the bank (including large loans by other state-owned banks), to help cover operating costs during the initial restructuring phase, or to be held on escrow accounts for the settlement of contingent liabilities that are disputed in court. Thirdly, the state's Rehabilitation Bank, has obtained an NBK loan to purchase "loss" loans from Bank TuranAlem at a gross value of US$61m equivalent, and Bank TuranAlem used the entire proceeds to repay its liability towards NBK. In addition, the Government has committed itself in a letter to the World Bank not to undertake any further recapitalization of Bank TuranAlem from the state budget.

(e) These and other actions have brought the bank back into compliance with most prudential norms, including the mandatory liquidity ratio. In addition, the bank agreed with NBK to limit the growth of its loan volume (net after the extensive provisioning) to 50 percent from March 97 to March 1998, and to limit its exposure to any single borrower to US$3 million, except for up to three exposures with a US$5 million ceiling. The bank does not yet meet the capital adequacy norms, though, and still constitutes a risk that required careful monitoring by NBK.

(f) The Government confirmed in a letter to Bank management, dated July 2, 1997, that it "will do [its] best effort to conclude the sale of the majority of the voting stock of Bank TuranAlem in a transparent process open to competition no later than by June. ... [The Government] will seek a strategic investor with strong capabilities and give consideration to ensuring adequate competition in the banking sector." The bank's rigorous restructuring is expected to facilitate this privatization. It has also been noted that several major foreign banks are contemplating to open branches in Kazakhstan, for which legislation requires first a one-year operation of a representative office; this interim period can be avoided by purchasing an existing bank. The authorities plan to intensify their investor search in September once an international audit of the bank's results through June 1997 will provide potential investors with more insight into the bank's recent income performance. The European Bank for Reconstruction and Development (EBRD) is preparing to assist the authorities in this privatization effort, and potentially to participate in the equity itself.

43. Given that it was unforeseen circumstances that prevented the authorities from liquidating Alem Bank when their privatization effort failed last year; given the impressive degree of restructuring and downsizing that has been achieved in a short time; and given the Borrower's firm commitment and improving prospects to privatize Bank TuranAlem within one year, these actions and commitments can be considered an appropriate substitute for the original tranche release condition regarding Alem Bank.

(ix) Implementation of key elements of an action plan, agreed with the World Bank, pursuant to the agreement dated May 1996 between NBK and Turan Bank or, alternatively, assumption of conservatorship over Turan Bank by NBK.

44. <u>This condition had been met. However, it was subsequently overtaken by a satisfactory alternative course of actions. The progress achieved towards sector reform objectives on this alternative route exceeds in many ways the targets of the tranche release condition.</u> This revised course of action involved the merger of Turan Bank with Alem Bank, and the rigorous restructuring of the resulting Bank TuranAlem, as described above.

45. Early last year Turan Bank, the former state industrial bank, had been the country's fourth largest bank (by gross value of assets) and fully in private hands. Its performance and financial stability were crippled by weak management, lack of control over regional branches, disputes and failed takeover attempts among owners, and the migration of its heavy industry clients, once privatized, to more dynamic banks. In September 1996, the bank's management including the CEO was replaced by a group of NBK staff. This situation came close *de facto* to a conservatorship by NBK. This new management team implemented a profound and detailed restructuring program. New lending was curtailed, lending to major defaulters ceased altogether, and the collection of non-performing loans was stepped up, except for loans under foreign credit lines where responsibility was blurred through state guarantees and lending instructions. These actions reduced the loan/deposit ratio to 1.04, and nominally brought capital adequacy in line with prudential norms (allowing for amortization of initial provisions over three years, and based on provisioning needs defined upon NBK on-site examination for lack of an international audit). Within a quarter year, the bank closed 17 of 83 branches, cut

staffing by 16 percent, and disposed of 25 percent of its fixed assets. Internal controls were strengthened, and all branches were made to report directly to headquarters. The agreed target of raising additional equity capital of US$2 million from private sources was not yet met, but was planned to follow this period of *de facto* conservatorship.

46. On January 15, 1997, the shares of Turan Bank were transferred to the state under applicable law, which immediately merged Turan Bank with the troubled Alem Bank as described above. The main purpose was to prevent a collapse of the large Alem Bank in an environment already affected by the recent bankruptcy of another large bank. A secondary motive, according to NBK, was to facilitate the replacement of private shareholders whose behavior in governing Turan Bank, which had negative capital, had indicated moral hazard and who continued to obstruct the necessary restructuring. NBK applied an amendment to banking legislation that allowed NBK to seize, against some compensation, the shares of banks with a negative net worth. The Government assured the Bank formally of its commitment to privatize the merged Bank TuranAlem no later than by mid-1998. In the meantime, the rigorous restructuring has continued and, in many respects, accelerated at Bank TuranAlem. Although data of the former Turan Bank is not fully comparable with that of today's merged Bank TuranAlem, it is fair to say that most of the restructuring actions for Turan Bank that had been agreed under the Loan have by now been exceeded by Bank TuranAlem.

(x) Passage of a law on bankruptcy that includes adequate provisions for its application and enforcement, or prescription of adequate rules, regulations or procedures for the application and enforcement of the Presidential Decree on Bankruptcy of 1995.

47. This condition has been met.. A new Law on Bankruptcy was passed by parliament on January 21, 1997, signed by the President, and came into effect on January 25, 1997. The law constitutes a major improvement over the prior Presidential Decree on Bankruptcy of 1995, and its content is substantially satisfactory. Different from the prior Decree, the new Law is highly detailed and includes a wide range of generally satisfactory provisions for the Law's application and enforcement. There are indications that the new Law has already contributed to making bankruptcy a more widely considered option for creditors, and that the number of bankruptcy applications has risen. The state itself, too, is now utilizing its role as creditor more actively to force bankruptcy on major debtors, especially through its Rehabilitation Bank and Enterprise Restructuring Agency.

V. CONCLUSION

48. The Borrower's implementation of the Program has been strong. Most measures have been implemented as planned. Where the original measures have proved no longer appropriate in light of events, the Borrower has substituted practical alternatives that pursue that same objectives and have been implemented rapidly in a satisfactory manner. Overall, the Program has impacted on the development of the financial sector in the manner and to the extent intended under the Loan. The environment has been made more conducive for sound banking sector growth, and the resolution of problem loans and the restructuring of critical problem banks have made major progress.

49. **Recommendation.** On the above basis, I recommend that the Executive Directors approve the release of the second tranche of the Loan. Upon approval, the Bank will notify the Borrower that the second tranche of US$90 million is available.

James D. Wolfensohn
President
by Caio K. Koch-Weser

SELECTED MACRO-ECONOMIC INDICATORS AND FINANCIAL SECTOR STATISTICS

Table 1. Kazakhstan: GDP, Money and Velocity

3/8/98 17:49	1997	1998				
	December, actual, including Budget Bank with NBK	January Outcome	March Projected	June Projected	September Projected	December Projected
GDP and Inflation (percentage change over						
same period a year earlier)		155,105				
Real GDP (quarterly)	2.0	93,862	3.0	3.0	3.0	3.0
GDP Deflator	12.0	86,718	8.7	9.4	9.7	9.8
CPI Inflation	11.3		10.7	10.9	11.6	10.4
		11,651				
Nominal GDP (millions of Tenge)	477,573	4,507	395,466	426,588	556,087	540,026
Quarterly	1,900,292	6,850	1,581,864	1,706,352	2,224,348	2,160,104
Annualize		295				
	177,257		160,039	174,132	196,967	216,689
Monetary Aggregates (millions of Tenge)	106,921		92,485	97,442	108,850	118,194
Broad Money	96,536		83,353	87,644	97,036	104,548
Reserve Money		82,211				
o/w currency	14,121		12,867	13,534	15,550	17,381
	3,736	72,895	3,736	3,736	3,736	3,736
Bank Reserves (R)	10,254	72,865	9,000	9,666	11,683	13,514
Currency holdings by commercial banks	131	29	131	131	131	131
Bank deposits at NBK						
Demand, time and enterprise deposits at NBK						
Currency held by households (C)	92,800		79,716	83,908	93,300	100,812
Deposits (D)	84,457		80,422	90,224	103,667	115,876
Deposits at commercial banks	84,421		80,385	90,187	103,630	115,840
Bonds/Promisory notes of banks	36		36	36	36	36
Ratios						
Velocity	10.78		9.88	9.80	11.29	9.97
Reserves/Deposits (r=R/D)	0.17	0.16	0.16	0.15	0.15	0.15
Currency /Deposits (c=C/D)	1.10	1.13	0.99	0.93	0.90	0.87
Money multiplier (m=[1+c]/[c+r])	1.66	1.65	1.73	1.79	1.81	1.83

Table 6. Grouping of operating STBs (second tire banks) by owner's equity

At the end of the period

Owner's equity within the limits of (mln. tenge)								Total STBs	Owner's equity, mln. tenge	
	<5	**5-20**	**20-80**	**80-130**	**130-500**	**500-1300**	**>1300**			
12.95	45	24	25	21	11	3	1	130	10 292.3	12.95
share, %	*34.62*	*18.46*	*19.23*	*16.15*	*8.46*	*2.31*	*0.77*	*100.00*		*share, %*
12.96	17	10	27	28	11	4	4	101	17 873.5	12.96
share, %	*16.83*	*9.90*	*26.73*	*27.72*	*10.89*	*3.96*	*3.96*	*100.00*		*share, %*
01.97	18	7	27	30	11	4	4	101	20 553.0	01.97
02.97	17	6	28	28	13	4	4	100	20 553.0	02.97
03.97	16	7	27	27	11	4	5	97	22 195.6	03.97
04.97	17	8	24	28	13	3	4	97	22 199.3	04.97
05.97	16	9	24	28	11	2	6	96	23 023.9	05.97
06.97	17	7	23	28	13	2	6	96	25 619.5	06.97
07.97	21	5	22	29	14	3	4	98	24 983.9	07.97
08.97	18	8	21	29	13	5	4	98	25 387.2	08.97
09.97	14	7	17	27	16	3	6	90	26 355.4	09.97
10.97	14	6	16	28	17	3	6	90	26 413.2	10.97
11.97	12	5	18	28	18	3	6	90	26 726.1	11.97
12.97	8	3	17	25	18	5	6	82	27 997.2	12.97
share, %	*9.76*	*3.66*	*20.73*	*30.49*	*21.95*	*6.10*	*7.32*	*100.00*		*share, %*
01.98	7	4	14	24	16	5	6	76	27 506.3	01.98
share, %	*9.21*	*5.26*	*18.42*	*31.58*	*21.05*	*6.58*	*7.89*	*100.00*		*share, %*

Table 2. Kazakhstan: Medium-Term Balance of Payments, 1995-2003
(million US dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Current account	-516	-752	-9	-1,434	-1,288	-1,306	-595	-574	-619
Trade balance	-222	-326	-384	-817	-666	-636	108	105	103
Exports (f. o. b.)	5,164	6,292	6,770	6,837	7,498	8,073	9,399	9,752	10,122
Non-oil exports	4,378	5,034	5,230	5,466	5,740	6,027	6,328	6,644	6,977
Oil exports	786	1,257	1,540	1,371	1,758	2,046	3,071	3,108	3,145
Imports (f.o.b.)	-5,387	-6,618	-7,154	-7,654	-8,164	-8,708	-9,291	-9,648	-10,018
Non-oil imports	-5,149	-6,304	-6,722	-7,273	-7,782	-8,327	-8,910	-9,266	-9,637
Oil imports	-237	-314	-382	-382	-382	-382	-382	-382	-382
Services (net)	-353	-475	-663	-668	-672	-721	-754	-730	-772
Non-factor services (net)	-208	-253	-336	-316	-352	-393	-414	-378	-408
Credit	535	675	853	812	867	927	991	1,060	1,135
Transport	352	432	494	518	544	572	600	630	662
Other	184	243	359	294	323	355	391	430	473
Debit	-743	-928	-1,189	-1,128	-1,220	-1,320	-1,405	-1,438	
Transport	-265	-357	-391	-418	-439	-461	-461	-400	-400
Other	-478	-571	-798	-709	-780	-858	-944	-1,038	-1,142
Factor services (net)	-145	-222	-327	-352	-320	-328	-339	-351	-365
Interest 1/	-65	-78	-92	-163	-231	-239	-250	-262	-276
Credit	40	29	50	62	61	61	61	61	61
International reserves	33	19	49	60	60	60	60	60	60
FSU debtors	7	10	1	2	1	1	1	1	1
Debt	-105	-107	-143	-225	-292	-301			
IMF	-17	-23	-25	-23	-18	-9			
Other	-88	-84	-118	-202	-275	-291			
Other factor services	-80	-144	-234	-189	-89	-89	-89	-89	-89
Unrequited transfers	59	50	75	50	50	50	50	50	50
Capital account	1,1160	1,374	1,617	1,600	1,433				
Medium and long-term credits	569	486	805	731	300	279	159	25	-23
Drawings on official loans	352	352	244	566	427	449	404	400	329
Drawings on trade credits	265	143	332	150	204	191	175	71	56
Bond issue (net)	0	200	350	245	0	0	0	0	0
o/w government	0	200	350	245	-200	0	0	-350	-245
roll-over	0	0	0	0	200	0	0	350	245
Amortization 1/	-48	-210	-121	-230	-331	-360	-420	-447	-408
o/w Other FSU	19	30	0	0	0	0	6	6	8
o/w to Russia	-23	0	0	0	0	0	0	0	0
Other banking	0	43	-92	0	0	0	0	0	0

system (NIR)									
Portfolio investment (net)	7	24	54	0	0	0	0	0	0
Direct *investment* (net)	964	1,137	1,269	1,269	1,333	1,366	1,366	1,366	1,366
Capital transfers (Migrants-net)	-381	-316	-419	-403	-200	-100	-50	0	0
Errors and omissions (net)	-488	-567	-155	0	0	0	0	0	0
Overall balance	156	55	490	65	- 145	239	879	816	724
Financing	-156	-55	-490	-65	-145	-239	-879	-816	-724
NIR of the NBK (increase)	-375	-228	-490	-65	-145	-239	-879	-816	-724
Foreign Exchange Assets (net)	-232	-55	-490	-65	-145	-239	-879	-816	-724
o/w Fund Credit (net)	142	135	-7	-95	-175	-132	-52	-28	-28
Purchases	142	135	0	0	0	0	0	0	0
SBA	142	135	0	0	0	0	0	0	0
EFF	0	0	0	0	0	0	0	0	0
Repurcha ses	0	0	-7	-95	-175	-132	-52	-28	-28
Exceptional financing	219	0	0	0	0	0	0	0	0
Arrears reduction	1	0	0	0	0	0	0	0	0
Inter-enterprise arrears (net)	0	0	0	0	0	0	0	0	0
Debt relief from Russia	217	0	0	0	0	0	0	0	0
Memoran dum									
GDP in US$	16,588	20,810	22,514	24,707	26,313	27,760	29,987	30,898	32,597
CA to GDP	-3.1%	-3.6%	-4.3%	-5.8%	-4.9%	-4.7%	-2.0%	-1.9%	-1.9%
NBK Gross Internation al Reserves		1,980	2,252	2,222	2,367	2,606	3,485	4,301	5,025
In months of imports of G&NFS		3.1	3.2	3.0	3.0	3.1	3.9	4.7	5.2

Table 3: Kazakhstan: External Financing Requirements
(in millions of US dollars)

	1997					1998				
	Q1	Q2	Q3	Q4	year (proj)	Q1	Q2	Q3	Q4	year (proj)
TOTAL FINAN CING REQUIREMENT	213	377	632	760	1,982	155	358	647	661	1,821
External Current Account										
deficit (excluding transfers)	- 116	368	417	379	1,047	203	205	654	423	1,485
Amortization payments	51	51	37	59	198	38	103	44	85	270
Errors and omissions	302	-210	5	58	155	0	0	0	0	0
Change in International Reserves of Banking system (+increase)	-23	168	174	264	582	-87	50	-51	153	65
COMMITED FINANCING	181	411	572	414	1,578	69	242	381	227	920
Transfers (net)	-52	-101	-112	-79	-344	-39	-75	-85	- 151	-350
Official loans	30	66	115	110	322					0
Multilaterals	12	66	107	101	287					0
World Bank	4	10	98	88	200					0
EBRD	6	0	5	6	18					0
ADB	2	56	3	7	69					0
Bilateral	18	0	5	4	26					0
Foreign commercial banks and firms	0	0	4	5	9					
Drawings on trade credits	88	109	71	64	332					0
Direct investment	115	338	498	319	1,269	108	317	466	378	1,269
IMF Purchases	0	0	0	0	0	0	0	0	0	0
UNCOMMITED FINANCING	32	-34	61	346	404	86	117	266	434	902
Multilateral	0	0	0	0	0	81	38	243	38	401
World Bank	0	0	0	0	0	16	27	199	10	251
PSRMAL	0	0	0	0	0	0	0	75	0	75
Pension Reform Loan	0	0	0	0	0	0	0	100	0	100
project loans	0	0	0	0	0	16	27	24	10	76
EBRD	0	0	0	0	0	5	1	9	10	26
ADB	0	0	0	0	0	60	10	28	6	104
Other	0	0	0	0	0	0	0	8	12	20
Bilaterals	0	0	0	0	0	4	9	17	100	129
JEXIM (III)	0	0	0	0	0	0	0	0	0	0
Japan (OECF)	0	0	0	0	0	4	3	13	94	115
France	0	0	0	0	0	0	6	3	2	10
Germany (KFW)	0	0	0	0	0	0	0	0	4	4
Foreign Commercial Banks	0	0	0	0	0	13	32	18	13	76
Drawings on trade credits	0	0	0	0	0	38	38	38	38	150
Bond issue	0	0	0	350	350	0	0	0	245	245
Portfolio investment	32	-34	61	-4	54	-50	0	-50	0	-100
EXTERNAL FINANCING GAP	0	0	0	0	-1	0	0	0	0	-1

Table 4. **Monetary review of banking system**

mln. tenge

	12.94	12.95	12.96	12.97	01.98
Net external assets	-533.6	76568.1	113454.0	134191.1	120806.9
Net international reserves	*-1022.0*	*76213.7*	*113086.6*	*131610.4*	*119487.6*
Gross international assets	*79988.0*	*132963.0*	*162682.7*	*186477.9*	*176175.5*
Monetary gold	20509.2	33529.6	48858.1	39577.6	41781.1
Cash in convertible currency (CC)	1460.8	2548.5	3721.6	3489.4	7277.0
Deposits in CC	58018.0	96884.8	110102.9	63840.5	49232.3
Credits in CC	...	...	...	4307.3	4326.5
Securities (excluding shares), CC	...	...	...	75142.0	73397.5
Other external assets, CC	...	...	...	121.1	161.1
Less: Liabilities, CC	*81010.0*	*56749.3*	*49596.1*	*54867.5*	*56687.9*
Short-term liabilities	39619.7	39733.9	45641.9	48652.0	49301.4
Mid- and long-term liabilities	41390.4	17015.4	3954.1	6215.5	7386.5
Other net external assets	***488.4***	***354.5***	***367.3***	***2580.7***	***1319.3***
Gross assets,	909.4	1098.3	1114.8	4545.1	2687.3
Less: External liabilities,	421.0	743.9	747.4	1964.4	1368.0
Net internal assets	**55950.7**	**39226.6**	**21537.3**	**43250.1**	**34416.4**
Net claims to the Government	***10831.4***	***24514.1***	***20851.1***	***35448.5***	***22575.2***
Claims	*20662.6*	*44571.1*	*43108.5*	*62305.8*	*58894*
Credits	17746.1	39104.4	34743.7	41479.2	3847.8
Securities	75.9	5395.5	8364.8	20826.6	55046.8
Others	2840.6	71.2	0.0	0.0	0.0
Less: liabilities	*9831.2*	*20056.9*	*22257.4*	*26857.3*	*36319.4*
Deposits	...	...	...	26684.7	36140.6
Others	...	...	...	172.5	178.8
Claims to the rest of economy	***112507.1***	***72652.6***	***64627.7***	***79227.1***	***82094.2***
non-financial organizations	*98504.9*	*61096.6*	*51404.7*	*72995.3*	*75678.6*
Credits	...	...	...	68142.1	70792.2
Securities	...	...	...	1449.8	1526.8
Others	...	...	...	3403.4	3359.6
non-banking financial organizations	...	...	...	*1383.1*	*1406.0*
Credits	...	...	...	98.1	129.7
Securities	...	...	...	23.8	23.6
Others	...	...	...	1261.2	1252.8
Non-commercial institutions servicing households	...	...	...	*270.9*	*265.8*
Credits	...	...	...	270.7	265.2
Others	...	...	...	0.2	0.5
Households	*14002.2*	*11556.0*	*13223.0*	*4577.8*	*4743.8*
Credits	...	...	...	4321.6	4420.9
Others	...	...	...	256.2	323.0
Other net internal assets	***-67387.8***	***-57940.1***	***-63941.5***	***-71425.5***	***-70253.0***
Other financial assets	...	...	...	4550.1	6156.4
Non-financial assets	...	...	...	15976.1	15537.1
Other assets	...	...	...	35948.7	26820.7
Less: assets accounts	...	...	...	-70970.5	-71710.5
Less: other liabilities	...	...	...	-56929.9	-47056.7
Liabilities (cash)	**55417.1**	**115794.7**	**134991.2**	**177441.3**	**155223.3**
Cash in circulation	20255.3	47998.2	62812.3	92799.7	82210.5
Deposits of non-financial organizations	29042.8	52605.0	51235.2	54682.4	42212.4
Deposits of non-banking financial organizations	...	...	...	1160.2	979.7
Deposits of non-commercial institutions servicing households	747.6	2443.3	1580.2	1634.4	2204.5
Households deposits	5371.3	12748.3	19363.5	27164.6	27616.2

Table 5. Classification of Assets and Contingent Liabilities of Second Tier Banks
(million tenge as of the end of the period)

January 1998						
	Principal amount of debt		Accrued remuneration (interest)		Actual provisions	
	amount	share, %	amount	share, %	amount	share, %
Total assets and contingent liabilities of SLBs, including:	**111643.4***	**100.0**	**3007.4**	**100.0**	**10170.1**	**100.0**
1. Standard	83240.4	74.6	1452.3	48.3	-	-
2. Doubtful	21173.0	18.9	1233.2	41.0	2963.5	29.1
- substandard	15753.7	74.4	621.3	50.4	1035.2	34.9
- unsatisfactory	3873.8	18.3	293.8	23.8	1163.3	39.3
- doubtful with enhanced risk	1545.5	7.3	318.1	25.8	765.0	25.8
3. Hopeless	*7230.0*	*6.5*	*321.9*	*10.7*	*7206.6*	*70.9*
Loans from the total amount of assets, including:	**78635.5***	**70.4**	**2993.0**	**99.5**	**7294.6**	**71.7**
1. Standard	54263.0	69.0	1438.0	48.0	-	-
2. Doubtful	19546.9	24.9	1233.1	41.2	2492.6	34.2
- substandard	14617.0	74.8	621.3	50.4	958.8	38.5
- unsatisfactory	3542.4	18.1	293.8	23.8	850.8	34.1
- doubtful with enhanced risk	1387.5	7.1	321.9	25.8	683.0	27.4
3. Hopeless	*4825.6*	*6.1*	*60.0*	*10.8*	*4802.0*	*65.8*
Contingent liabilities, including:	**12215.3**	**10.9**	**60.0**	**2.0**	**1661.2**	**16.3**
1. Standard	9771.9	80.0	-	-	-	-
2. Doubtful	819.9	6.7	60.0	100.0	55.8	3.4
- substandard	719.8	87.8	55.0	91.7	35.8	64.2
- unsatisfactory	100.1	12.2	5.0	8.3	20.0	35.8
- doubtful with enhanced risk	0.0	0.0	0.0	0.0	0.0	0.0
3. Hopeless	*1623.5*	*13.3*	*0.0*	*0.0*	*1605.4*	*96.6*

* non-classified assets of Rehabilitation Bank and Eximbank are not included.

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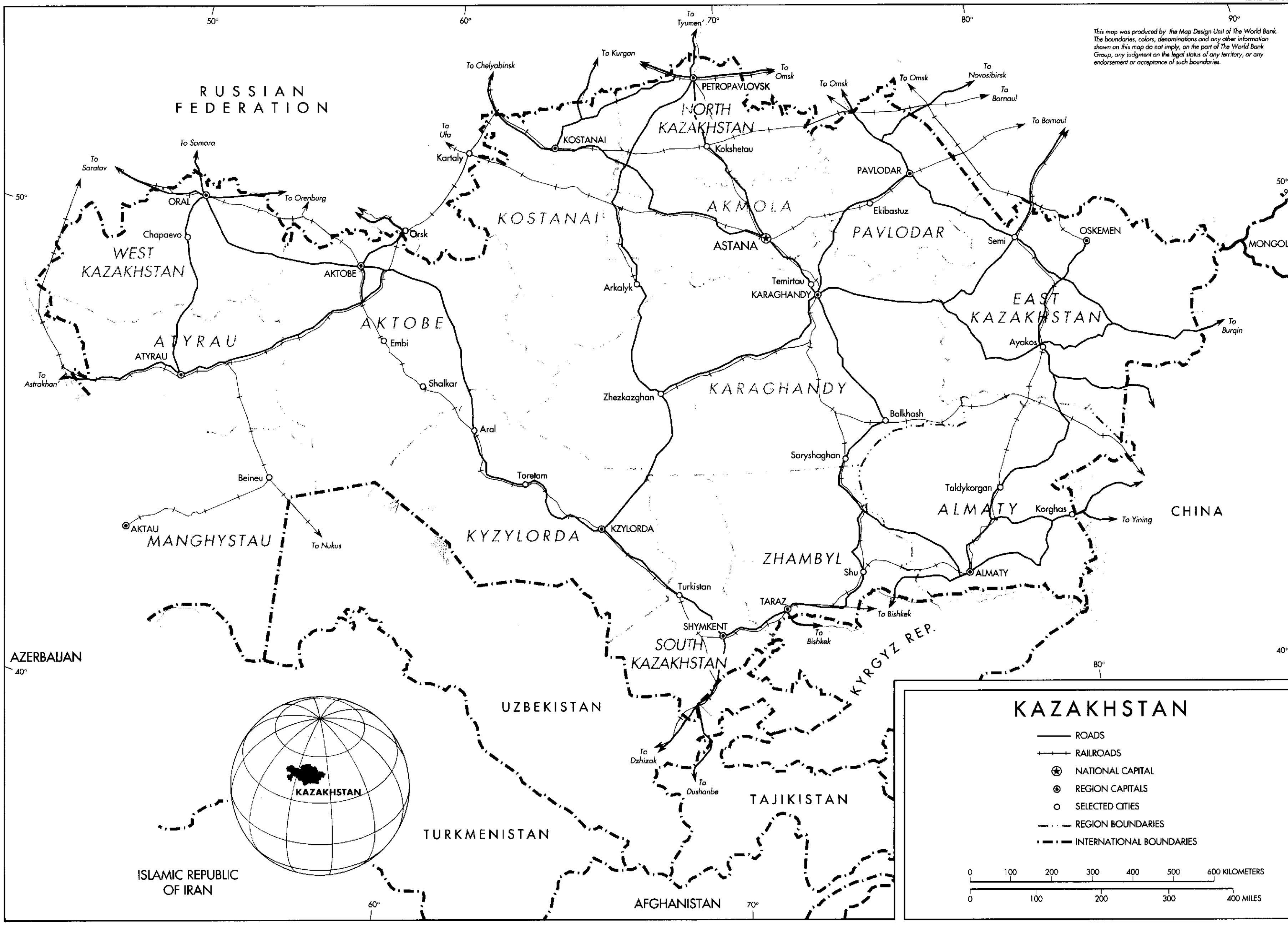

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