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Charity Registration Number: 208223

REP Programme Paper: REP PP 2009/01

Kazakhstan: End of the Banking Boom

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11 May 2009

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Kazakhstan, a major Caspian oil supplier, has emerged over the last decade as a shining example of successful economic development in post-Soviet Central Asia. As the prices of oil and gas skyrocketed, Kazakhstan's banks borrowed heavily on international markets to finance a massive construction, investment and real estate boom. But the international credit crunch has left Kazakhstan's financial system – once the most robust in the former Soviet Union – tottering on the brink of a precipice, threatening to take a good chunk of the country's economy down with it. Is the Kazakh banking crisis a test case for other emerging market economies?

Since the state takeover of Kazakhstan's largest bank, Bank Turan-Alem (BTA) in February, its former chairman, Mukhtar Ablyazov, has been on the run. After the bank failed to raise enough money to bolster its reserves to the level demanded by the government, Kazakhstan's sovereign wealth fund, Samruk-Kazyna, stepped in to assume a controlling share in BTA. Ablyazov left Kazakhstan for London shortly thereafter, prompting Kazakh prosecutors to issue an international arrest warrant for him on embezzlement charges. Stating that the charges against him are politically motivated, Ablyazov maintains that the takeover was nothing short of corporate raiding undertaken by elite factions that had been waiting to seize control of one of the country's prize assets.

Manoeuvring for power

Before the credit crunch hit, BTA was the up-and-coming wunderkind on the emerging markets finance scene, making inroads into one country after another as Ablyazov declared his ambition to make BTA the first post-Soviet bank to claim the title of international player. While many an influential banker has been taken down by the recent global financial turmoil, Ablyazov's fall appears to be connected to elite manoeuvring within Kazakhstan's upper echelons of power. For two decades independent Kazakhstan's first – and so far only – president, Nursultan Nazarbaev, has adeptly maintained a balance among the country's elite factions in order to prevent any one group from seizing too big a share of the state's vast riches. Until relatively recently, the two most powerful groups were headed by the president's sons-in-law, Timur Kulibaev and Rakhat Aliev. The latter was charged in 2007 with fraud and the kidnapping of two officials from Nurbank, in which he then owned a majority share. Aliev is currently in Vienna, fighting extradition. The debacle ended speculation that Aliev's wife, Dariga, was being groomed to succeed her father as president of the Central Asian state.

Since Aliev's downfall, Kulibaev has managed to consolidate his position, particularly in the financial sector, where he has *de facto* control of Kazakhstan's second largest bank, Kazkommertsbank, and is the majority shareholder of the third largest bank, Halyk. Although Nazarbaev removed Kulibaev in September 2007 as the head of the Samruk State Holding Company, which was widely regarded as a move to rebalance power among elite factions, in October 2008 Kulibaev was reinstated as a deputy head of Samruk-Kazyna – the primary conduit through which the state assumed control of BTA four months later. While the banks under Kulibaev's control managed to escape a state takeover, BTA as well as the country's fourth largest lender, Alliance, were not treated so gently. Former chairman Abylazov has disputed that BTA was on the verge of collapse at the time it was taken over by the state, arguing that the global financial crisis provided the ideal opportunity for pro-presidential groups to step in and take control.

Western foul play?

The government takeover in February triggered a clause in BTA's debt contract allowing creditors to ask for early repayment in the event of a material change of ownership of the institution. In a move predicted by Kazakhstan's small but vocal opposition, in mid-April Morgan Stanley and an unnamed bank demanded accelerated repayments. This caused BTA's management to announce that it was unable to repay its entire external debt simultaneously and would suspend all payments on its debt principal, thereby tipping the bank into partial default. Following the announcement, Fitch Ratings and Standard and Poor's Rating Services downgraded BTA to 'restricted default' and 'default', respectively.

Morgan Stanley is alleged to hold a large CDS position that will pay out only in the event of a clear default. Consequently, observers have speculated that Morgan Stanley is set to benefit from triggering a default, which enables the US bank to cash in on credit default swaps (CDS), or debt insurance, written on BTA. Noting that this is not just a Kazakh tale being played out, the *Financial Times* observed that the BTA story demonstrates that the credit world has become a hall of mirrors, where nothing is necessarily as it seems.¹

¹ Tett, Gillian, 'Kazakh Banks Fall Foul of CDS', *Financial Times*, 30 April 2009

Test case

After creditors sought to accelerate debt repayment, BTA management said it would announce a plan to restructure some \$15 billion of debt, which is expected to lead to major losses for bondholders. If creditors refuse to restructure BTA's debt, bankruptcy looms for the bank. This would very likely bring down Kazakhstan's financial sector and much of the country's economy with it.

Matters went quickly from bad to worse at the end of April, when a group of BTA shareholders based in Amsterdam and Vienna filed complaints with the arbitration bodies of the United Nations and World Bank against the Kazakh government for damages allegedly incurred during the forced takeover of the bank. They have threatened a barrage of international arbitration cases that could potentially reach \$20 billion in claims.

Analysts believe that the crisis currently embroiling Kazakhstan's banking sector is serving as an important test case scenario insofar as BTA's default could portend other corporate and bank defaults in the former Soviet Union over the next year. A large number of defaults would in turn have a significant negative impact on Western banks with a large exposure in the region. The BTA default is also a landmark case as it is the first time that procedures have begun to settle credit-default swaps contracts involving an emerging market bank.

The World Bank has suggested that Kazakhstan should consider a precautionary stand-by deal with the International Monetary Fund, but Kazakh officials have rejected the suggestion, stating that the state has sufficient reserves of its own. Although some analysts have predicted that the ailing banking sector will begin to rally as early as 2011, at the moment Kazakhstan's oft-stated ambition to become one of the world's 50 most competitive nations looks like a far-off dream.