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Bank Crisis and Restructuring: Evidence from Kazakhstan

Orynbassar Sh. Tumenbayeva

Kazakh Economic University Named T. Ryskulov, Almaty, Kazakhstan

Abstract: This paper investigates banking crises resolution practices in Kazakhstan. The study found, that the Government of Kazakhstan has followed international practices to resolve crises in the financial sector with a small adjustment to the peculiarities of development and the state of our banking sector. First of all, the Government, the National Bank of Kazakhstan and FMSA have developed joint action plan to stabilize the economy and financial system and once it is achieved, turn it to financial stability and restructuring reforms. Despite all efforts made by authorities Kazakhstan's banking sector has not regained its pre-crisis level of development.

Key words: Bank restructuring · Non-performing loans · Bank crisis · Systemic crisis · Financial stability · Anti-crisis program · Bank restructuring reforms

INTRODUCTION

According to Hoelscher and Ingves (2006), systemic crisis is as a threat to the stability of the banking system and has a negative affect on the payment system that reduces lending to the real sector. Systemic crisis is characterized by difficulties in distinguishing between solvent and insolvent banks. Accordingly, creditors, including depositors start to withdraw their money from all banks and thereby threaten the stability of the overall banking sector [1].

Laeven and Valencia (2012) defined "a banking crisis as systemic if two conditions are met: 1) significant signs of financial distress in the banking system (as indicated by significant bank runs, losses in the banking system and/or bank liquidations) and 2) significant banking policy intervention measures in response to significant losses in the banking system." They also considered, that banking crisis in Kazakhstan, which started in 2008 became systemic banking crisis in 2010 [2].

Hoelscher and Ingves (2006) argued, that during a systemic crisis policy should focus on: 1) the protection of the payment system, 2) limiting the loss of depositor confidence, 3) develop and implement a strategy to restore the solvency of the banking system, 4) prevent deterioration of macroeconomic indicators in the future [1].

Many researches, focused on banking crisis, found supporting banks with liquidity as one of the methods of bank crisis containment. As noted earlier, in the early stages of the financial crisis, lenders begin to withdraw funds from all banks of system. Consequently, even a "good" bank may suffer from such actions by creditors. Lack of sufficient liquidity in the bank accelerates deterioration and collapse of the banking system [1-4].

Deposit insurance as the next method of crises containment has proved its utility in the completion of a bank panic. Many countries that face accelerating the withdrawal of deposits, used deposit insurance scheme to restore private sector confidence in the financial system [1- 4].

When government does not have possibilities to effectively use two previously listed stabilization tools, administrative measures can be used as an alternative method of crisis containment. These measures are aimed at changing the condition of the deposit agreements and lead to the "freezing" of deposits. Three possible options for these measures are: 1) the prohibition of deposit removal, 2) the extension of deposit maturity and 3) securitization of deposits [1-4].

Only after successful completion of crisis containment phase, regulators may turn to bank restructuring processes.

Corresponding Author: Tumenbayeva, Kazakh Economic University named T. Ryskulov,45, Zhandosov Street, Almaty, Kazakhstan.

Table 1: Banking sector key indicators

	2007	2008	2009	2010	2011	2012
Assets, bln.USD	97,13	98,44	77,85	81,57	86,37	92,08
Liabilities, bln USD	85,29	86,41	84,45	72,64	77,59	78,78
Equity/(Deficit) bln USD	11,85	12,03	-6,60	8,92	8,78	13,30
Net Profit/(Loss), bln USD	1,80	0,09	-19,09	9,63	0,23	-1,32
Loans, bln USD	73,72	76,48	64,93	61,46	70,57	77,34
Deposits, bln USD	53,40	56,90	52,53	46,45	52,54	56,61
ROA	1,90%	0,09%	-24,52%	11,80%	0,27%	1,88%
ROE	15,23%	0,76%	289,18%	107,90%	2,61%	28,11%

Source: KFN NBK RK

Banking Sector Restructuring in Kazakhstan: Kazakhstan's economy, including the banking sector was not prepared for the crisis, the level of threat and a significant loss. The crisis caught unaware Kazakh banking sector, which was manifested in deterioration of assets in the banking system.

Table 1 shows that in 2009 the overall banking sector showed a net loss of US$ 19, 09 billion and assets of the banking sector also declined during this period.

In addition, three leading banks defaulted on their debt in April 2009.

In this situation, the Government of Kazakhstan, the National Bank of Kazakhstan (hereinafter - NBK) and FMSA have developed:

- Joint action plan to stabilize the economy and financial system for 2009-2010. (Hereinafter - The Anti-Crisis Program);
- Financial stability and restructuring reforms.

Anti-Crisis Program: Main provisions of the Anti-Crisis Program are designed to maintain and contain the crisis of the financial sector. As already noted, the crisis caught our banks off guard - a sharp drop in the level of external borrowing and the limited liquidity of the domestic market, the poor quality of the loan portfolio, as well as the deadline for repayment of external liabilities of banks. Among the taken measures, there is a need to highlight the followings:

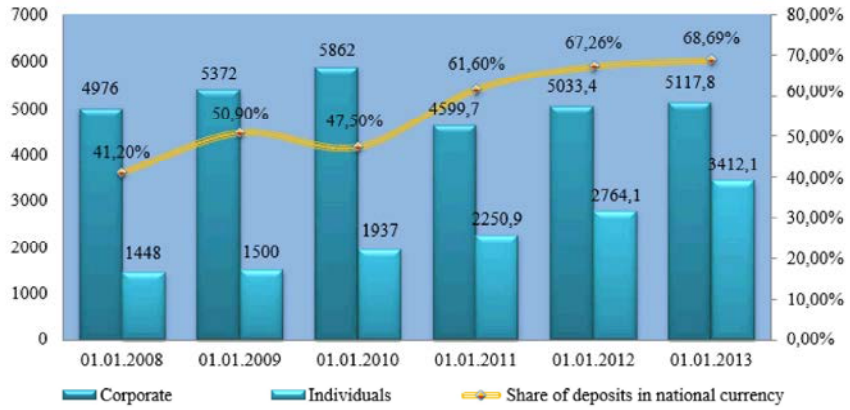
- Additional capitalization of the four leading banks through the purchase of common and preferred shares, as well as providing them with subordinated loans;
- Establishment of a Fund of Distressed Assets;
- Increasing the amount of blanket guarantee up to KZT 5 million (approximately U.S.$33, 3 thousand).

On February 2nd 2009 The Government has acquired approximately 75 percent of the shares of JSC "BTA Bank" for KZT251 billion. In March 2009, between the Fund Samruk-Kazyna and JSC "Alliance Bank" was signed a deposit agreement in the amount of KZT24 billion to support the financial stability of the bank and the subsequent capitalization. On December 31st, 2009 Fund Samruk Kazyna bought 100% of ordinary and preferred shares of JSC "Alliance Bank".

The Government entered two other leading banks: "Halyk Bank of Kazakhstan" and "Kazkommertsbank " by purchasing additional shares.

According to Information Memorandum of BTA Bank, the Government's capital injections into Kazakhstan's banking sector are estimated at 6.4 percent of Kazakhstan's GDP in 2009, compared, for example, to the United Kingdom and the United States where, according to the IMF, capital injections represented 3.9 percent and 2.2 percent, respectively. The total amount of capital injected into Kazakhstan's banking sector was U.S. $7, 4 billion as of March 14th 2011 [5].

Restructuring of liabilities of BTA bank, Alliance bank and Temirbank had a negative impact on the ability of other banks to borrow on acceptable terms in the international capital markets. Due to the lack of external financial resources, the importance of domestic deposit market increased and needed to strengthen the confidence of depositors in the banking system. As part of the state program to solve this problem it was decided to increase the amount of guaranteed compensation on deposits of individuals with KZT1 million to KZT 5 million (approximately U.S.$33,3 thousand, exchange rate USD/KZT= 150). As a result, despite the negative trends in the economy and the banking system, public confidence in the banking sector has not been lost, customers' deposits as of January 1st 2008 slightly decreased from 36, 2 percent to 31, 3 percent as of January 1st 2013 (Figure 1).



Source: KFN NBK RK
Fig. 1: Deposit Dynamics

Financial Stability and Restructuring Reforms: On October 23 2008, new legislation relating to the stability of the Kazakhstan financial system was adopted. The main objectives of the new financial system stability law are improvement of early detection mechanisms for risks in the financial system; provision the Government with powers to acquire shares in commercial banks that face financial problems and improvement of the overall condition of financial institutions in Kazakhstan. The law also consolidates authority to oversee large and second-tier Kazakhstan banks and provides additional mechanisms for supervising commitments made by banks and other financial institutions [6].

Prior to July 2009 when the Restructuring Law was adopted, there was no law in Kazakhstan, which would allow for creditor claims to be restructured on a basis involving less than 100 percent consent of the affected creditors. Creditors not wishing to participate in a restructuring had the ability to set off their claims against a bank's assets or bring litigation in any jurisdiction where any of these assets are located [5].

The restructuring process set out in the Restructuring Law is designed to be fair to the affected creditors and should ensure that a restructuring effected by it will be capable of international recognition in countries (such as the United Kingdom and the United States) that have adopted legislation based on the Model Insolvency Law [7].

The second principal feature of the Restructuring Law is the amendment of the existing legislative framework allowing the segregation of the "good" assets and liabilities of a distressed bank and the transfer of them to another bank (or several banks) or to a specialised stabilisation bank.

"A stabilisation bank would be a special purpose company established by the FMSA on an *ad hoc* basis and would have a special status under the Banking Law and a limited scope of business compared to ordinary commercial banks. Due to its special status and purpose, the stabilisation bank would not be subject to normal capital adequacy and other prudential requirements. Its main role would be to hold "good" assets while the segregation of the "good" and "bad" assets of the distressed bank was in progress. Upon completion of the segregation process, the stabilisation bank would transfer the "good" assets to another bank designated by the FMSA, subject to the consent of the depositors and other creditors of the stabilisation bank. The procedures for obtaining this consent would be similar to the procedures for obtaining the depositors' and creditors' consent to the initial transfer of "good" assets from the distressed bank" [5].

CONCLUSION

Management of banking crises requires accurate and fast decisions from the authorities. Finding "innovative" solutions may waste time and this can lead to the collapse of the entire banking system.

In order to solve systemic banking crisis the Government of Kazakhstan deployed extensively liquidity support, significant restructuring costs and nationalizations. However, despite the measures taken by the Government, the banking sector was not able to restore pre-crisis period profitability performance.

The following preventive measures contribute to strengthening the supervisory framework: 1) the establishment of an independent supervisory authority

and control, 2) consolidated supervision for careful monitoring of loans to related parties and 3) a strong legal protection for supervisors.

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