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ISLAMIC FINANCE INDUSTRY IN KAZAKHSTAN: THEN AND NOW

Kazakhstan is the first Central Asian State to have established the Islamic finance sector and introduced its legal and regulatory framework. This article reviews the history and development of Islamic finance in the Republic of Kazakhstan. The first section outlines the events and experiences of this industry chronologically, and examines it historically. The second section scrutinizes laws on Islamic financing and amendments hereto, considers the various institutional initiatives, and critically analyses the implementation of the Islamic finance master plan. The research assessed the effectiveness of Kazakhstan's Islamic finance master plan of 2012–2020 and analyzed the content of the new master plan of 2020–2025. The findings suggest that Kazakhstan's Islamic finance market has not grown to date as expected despite numerous reforms and measures aimed at developing the industry. The research also revealed the following major challenges impeding its growth: 1) a weak legal and regulatory framework; 2) tight regulations inhibiting the incorporation of Islamic financial institutions; 3) a dearth of Islamic finance experts; 4) a low public awareness of the Islamic financial products. Hence, taking the proper measures to address these challenges is crucial for the growth of Islamic finance industry in Kazakhstan.

Key words: Islamic finance, Kazakhstan, challenges, legal framework.

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Қазақстандағы исламдық қаржыландыру индустриясы: өткені мен бүгіні

Қазақстан Орта Азия мемлекеттерінің арасында бірінші болып исламдық қаржыландыру индустриясын дамытуға ұмтылыс жасап, осы салада заңнамалық-құқықтық база қалыптастыруды қолға алған мемлекет. Бұл мақалада Қазақстан Республикасындағы исламдық қаржыландыру индустриясының өткен тарихы мен бүгінгі даму қарқыны зерделенді. Бірінші бөлімде Қазақстанда жүзеге асқан исламдық қаржы саласындағы тәжірибелер мен оқиғалар хронологиялық тәртіпте келтіріліп, оларға тарихи талдау жасалды. Екінші бөлімде еліміздегі исламдық қаржыландыру индустриясы бойынша орын алған заңнамалық өзгерістер мен толықтырулар, түрлі институционалды бастамалар, индустрияны дамыту үшін қабылданған жол карталары сыни талдау әдісін қолдану арқылы зерттелді. Еліміздегі 2012 – 2020 исламдық қаржыны дамытуға бағытталған стратегиялық жол картасында белгіленген жоспардың орындалу барысына баға беріліп, 2020 – 2025 жылдарға арналып бекітілген жаңа жол картасының мазмұны талдауға алынды. Зерттеу нәтижесі Қазақстан нарығының көлемі исламдық қаржыландыру индустриясын дамыту бағытында жүзеге асқан түрлі реформалар мен бастамаларға қарамастан әлі күнге дейін дiттеген межеге толық жетпегендігін көрсетті. Талдау нәтижесінде елдегі исламдық қаржы саласының қарқынды дамуын тежеуші мынандай факторлар анықталды: 1) исламдық қаржы бойынша құқықтық инфрақұрылымның әлі толықтай жетілмеуі; 2) қаржы институттарының құрылуы мен қызмет етуіне байланысты заңнамалық талаптардың күрделілігі; 3) сала бойынша маманданған кадр әлеуетінің жетіспеушілігі; 4) жергілікті халықтың исламдық қаржы өнімдері туралы ақпараттану деңгейінің төмендігі.

Түйін сөздер: Исламдық қаржыландыру, Қазақстан, кедергілер, құқықтық инфрақұрылым.

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Индустрия исламского финансирования в Казахстане: прошлое и настоящее

Казахстан – первая страна Средней Азии, приложившее усилие для развития исламской финансовой индустрии и формирующая законодательно-нормативную базу в этой отрасли. В статье изучены история и интенсивность современного развития индустрии исламского финансирования в Республике Казахстан. В первой части в хронологическом порядке приведены кейсы (события и опыты), в области исламских финансов, реализованные в Казахстане и проведён исторический анализ. Во второй части методом критического анализа исследованы законодательные изменения и дополнения, различные институциональные инициативы, дорожные карты развития, имевшие место в индустрии исламских финансов страны. Проведены оценка достижения планов стратегической дорожной карты, направленной для развития исламского финансирования в стране на 2012-2020 гг. и анализ содержания утвержденной новой дорожной карты на 2020-2025 годы. Результаты исследования показывают, что не смотря на реализацию различных реформ и инициатив, направленных на развитие индустрии исламского финансирования до сих пор не достигнуты цели рынка исламских финансов в Казахстане. В результате анализа выявлены следующие факторы, препятствующие интенсивному развитию отрасли исламских финансов в стране: 1) не полностью развита правовая инфраструктура по исламскому финансированию; 2) сложность законодательных требований, связанных с открытием и функционированием финансовых институтов; недостаток кадровых ресурсов по данной отрасли; 4) низкий уровень осведомленности местного населения об исламских финансовых продуктах.

Ключевые слова: Исламское финансирование, Казахстан, преграды, правовая инфраструктура.

Introduction

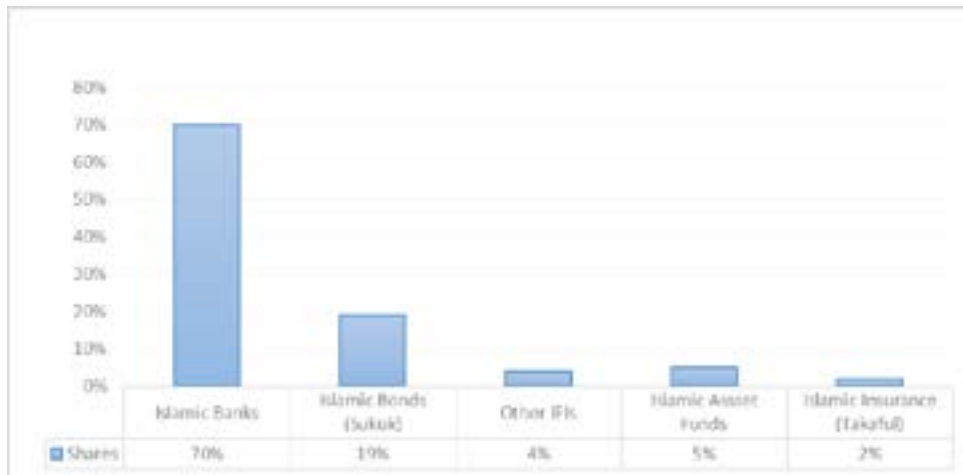
Islamic finance is one of the world's fastest growing industries. The increasing success rate of Islamic finance industry in the global arena, as well as its acceptance as an effective instrument for financing, is predicated on the presumption that Islamic financial institutions operate more ethically, thus upholding a higher moral standard and resulting in risk moderation and lower moral hazards (ZICO Shariah, 2020). Furthermore, Islamic finance is closely linked to the real economic sector and its operations are equity- and asset-backed. It fosters risk sharing, financial inclusion, and social welfare. For instance, Islamic banks engage in trading, leasing, rendering fee-based services, and investing in equities and real estate rather than simply collecting interest income on credits. The core principles of Islamic finance that are aimed to bring economic and social justice are: a) prohibition of *Riba* (charging interest on loan), b) prohibition of *Maysir* and *Qimar* (gambling), c) prohibition of *Gharar* (excessive contractual uncertainty), and d) prohibition of engaging in unethical or immoral activities. These qualities have been shown to contribute to the systemic resilience of financial systems globally.

According to the Islamic Finance Development Report 2020 (ICD-Refinitiv, 2020), the global assets

of the Islamic financial industry maintained double-digit growth rising 14% to 3,374 trillion US dollars in 2020 and projected to reach 4,94 trillion US dollars by 2025. It further reports that the Islamic finance industry assets are distributed as follows: 70% – Islamic banks, 19% – Islamic bonds (*Sukuk*), 4% – other Islamic financial institutions, 5% – Islamic asset funds, 2% – Islamic insurance companies. Currently, there are 1595 Islamic financial institutions operating around the world, including 527 Islamic banks, 745 Islamic funds, and 323 Takaful companies. The global industry is led by five countries: Iran, Saudi Arabia, Malaysia, the UAE, and Qatar.

Among the Commonwealth of Independent States (CIS), Kazakhstan is the first nation to embrace the Islamic finance trend in 2009 with a strategic plan and ambition to become the regional Islamic finance hub. Several initiatives have been undertaken to facilitate the development of Islamic finance industry in the country: making amendments in the legislation for Islamic banking and insurance sectors, establishment of Islamic financial institutions – two Islamic banks and a cooperative Takaful company, two leasing (*Ijarah*) companies and an Islamic microfinance enterprise, in addition to issuance of corporate *Sukuk*.

Table 1: The Global Islamic Finance Industry



Source: (ICD-Refinitiv, 2020)

Justification of the choice of articles and goals and objectives

Kazakhstan aspires to be a leader in Islamic finance in Central Asia. It is vital to have a stable financial system that allows for the mobilization of both internal and external capital in order to boost economic growth and manage external shocks (ZICO Shariah, 2020). Recognizing Islamic finance's contribution to the real economy and financial system stability, Kazakhstan chose to promote the country's Islamic finance industry. Since 2009, it has passed and amended numerous laws and launched institutional initiatives. Launched in 2018, Astana International Financial Center (AIFC) is set to develop the Islamic finance industry, as part of its objectives, thus, demonstrating Kazakhstan's interest in Islamic finance. Recently, the new Islamic finance industry development master plan was endorsed with the aim of increasing the market share of Islamic financial institutions in Kazakhstan by year 2025 (ZICO Shariah, 2020: 18).

According to the Agency for Regulation and Development of Financial Market of the Republic of Kazakhstan's 2020 report (AFR, n.d.), Kazakhstan's two Islamic banks have assets worth of 81.9 billion tenge, indicating a 45 percent year-on-year increase. Over the last three years, the Islamic banks' assets have increased by 30.3 percent. However, as compared to the conventional financial sector, the Islamic banks have a negligible domestic market share making up 0.26 percent of the country's financial industry. However, despite the numerous initiatives and efforts made over a decade, the entire current share of Islamic finance assets in Kazakhstan

remains significantly lesser than 1% of total domestic financial assets. This fact raises a number of concerns: What are the hurdles to growth of Islamic financial institutions domestically? Is it due to poor legal and regulatory frameworks? Is it owing to a scarcity of human capital with Islamic financial expertise? Is it due to a lack of awareness among locals about Islamic financial products? Is it because Islamic banks underperformed in the market? So, the aim of this study is to provide objective answers to these questions and offer recommendations for promoting the growth of Islamic finance industry in Kazakhstan.

Scientific research methodology

Addressing the research objectives, the study reviews the historical evolution of Islamic finance industry in Kazakhstan, outlines its current status and highlights the trends and challenges faced by the industry. The article critically examines the existing literature by reviewing scholarly articles, industry reports, and legal documentations, and collects and analyzes the primary (interviews) and secondary data (statistics). The findings of the study are expected to assist in formulation of policy recommendations addressing the needs of Islamic finance industry in the country.

The remainder of the article is structured as follows: *Section 2* overviews the historical development of Islamic finance in the country, discusses the current state and highlights its strengths and weaknesses. *Section 3* discusses the research findings, and *Section 4* concludes the study.

Main part

Evolution of Islamic Finance Industry in Kazakhstan

The growth of Islamic finance industry in Kazakhstan can be divided into three phases: (1) initiation phase with the establishment of the first

Islamic Bank in 1991, (2) enactment of special laws and regulations in 2009 and incorporation of new Islamic financial institutions, and (3) approval of new roadmap for the development of Islamic finance industry in Kazakhstan by 2025.

Figure 1: Phases of Islamic Finance Industry Development in Kazakhstan



Phase 1: Recognition and Initiation

Local experts attribute the development of the Islamic finance industry in Kazakhstan to the adoption of a special law in 2009. In fact, this progress can be traced back to country’s independence. The first Islamic bank was incorporated in 1990 during the era of the Kazakh Soviet Socialist Republic. To set bilateral relations with the Kingdom of Saudi Arabia, the Kazakh Soviet Socialist Republic enacted a resolution establishing an Islamic bank. Resolution No.472 was passed on November 30, 1990 (Resolution of Ministers Council of Kazakh SSR, 1990). It pioneered the establishment of the first Islamic financial institution in Central Asia. Following the country’s independence in 1991, the first President Nursultan Nazarbayev issued Resolution No.5, which resulted in the incorporation of al-Baraka Bank under the leadership of Sheikh Salih Kamil. The bank provided financing to the oil and gas industry and was one of its international investors (Baidaulet, 2019: 21). At its earlier stage, al-Baraka Bank experienced some challenges, when Kazakhstan entered a transitional period in the early 1990s. Thus, al-Baraka Bank operated in the country for several years before ceasing its operations in 1997 and turned into Kaspi Bank (Wolters, 2013: 7). Later, a US-citizen Yahya Abdurakhman and several Arab investors founded a Texaka Bank joint enterprise which led the industry. Soon, after three years, it was rebranded as Lariba Bank (which translates as “no-interest bank”). Lariba Bank mainly focused on financing the real estate sector, as well as small and medium enterprises. However, in 2006, the shareholders decided to convert it into a conventional bank named Asya Credit Bank (Baidaulet, 2019: 21).

On November 30, 1995, Kazakhstan granted access to the Islamic Development Bank (IsDB),

which was followed by opening a regional office in Almaty; this constituted a major development in the industry. Consequently, Kazakhstan invited the Islamic Corporation for Development (ICD), the arm of IsDB, to serve the private sector. According to IsDB report, total of 84 projects had been supported by 2009, with 71 of them being completed and 13 continuing the operations. The following economic sectors were financed (completed projects): agriculture – 30 projects, knowledge and innovation – 9, energy – 2, financial sector – 19, healthcare and social security – 3, mining industry – 6, as well as information technology and communications – 2 projects (IsDB, n.d.).

In early 2000 the local commercial banks sought to raise financing from Middle Eastern Islamic banks. One of the largest local banks, Bank Turan Alem, became the first institution to acquire a credit of 250 million US dollars from Arab, British, and Malaysian Islamic banks in 2003. Since 2005 until the 2008 global financial crisis, several local banks followed suit by securing large loans from overseas Islamic banks (Khaki, Malik, 2013: 16). The financing received by Bank Turan Alem was structured on *Wakala* contract. The funds were channeled to local small and medium enterprises from various industries, especially those from the agricultural sector, using Islamic financial arrangements such as *Ijara*, *Murabaha*, and *Istisna* (Alieva, 2016: 202).

As previously noted, Bank Turan Alem was the first Kazakh commercial bank to raise funds from foreign Islamic financial institutions. During 2003-2009 it obtained several credits from Islamic banks in the Middle East. For instance, in 2007, the bank received a syndicated loan amounting to 250 million US dollars from Adu Dhabi Islamic Bank,

CIMB, and Barclays Capital; the deal was sealed by a *Wakalah* contractual arrangement. The funds were subsequently allocated through a *Murabaha* scheme. In the absence of a Shariah board at Bank Turan Alem, the internal Shariah board of Abu Dhabi Islamic Bank ensured Shariah compliance of the transactions (BTA, 08.05.2007). Furthermore, Bank Turan Alem established a special department to build an effective collaboration with Islamic banks. In 2007, Bank Turan Alem and the Emirates Bank Group signed a memorandum of understanding on the development of Islamic finance in Kazakhstan and other Central Asian states. To expand its business, Bank Turan Alem had established its branches in Russia, Ukraine, Belorussia, Georgia, Armenia, Tatarstan, and Kyrgyzstan (BTA, 12.07.2007). From that perspective, Middle Eastern Islamic banks viewed Bank Turan Alem as a gateway to develop their operations throughout the Commonwealth of Independent States (CIS) (Janturin, 2019).

Between 2005 and 2009, Middle Eastern Islamic banks provided financing to several other Kazakh commercial banks. The Bank Center Credit raised 38 million US dollar worth of investment during 2006-2007 from five banks: Abu Dhabi Islamic Bank, the Commercial Bank of Qatar, Boubayan Bank, Dubai Bank PJSC, and Habib Bank. Between 2007 and 2009, Alliance Bank received a 150 million US dollar loan from Abu Dhabi Islamic Bank and Calyon Bank. Then, in 2009, Halyk Bank got a 100 million US dollar investment from IsDB (Iskhakov, 2010: 75).

According to Bekkin, a Russian expert in Islamic finance, prior to the 2008 global financial crisis, Kazakh banks obtained a significant amount of financing from the Middle East and South-East Asia driven by the excessive liquidity in these regions (Bekkin, 2010: 267-268).

Kazakh banks had large debt exposures mainly to Western banks, and the 2008 global financial crisis had an adverse impact on ability to pay back the borrowed funds. As a result, Bank Turan Alem, Alliance Bank, Temir Bank, and other local banks declared their bankruptcies; as a result, they were unable to repay their debts to their Islamic financiers. Because the shareholders and management of the aforementioned banks did not respond their debt repayment demands that time, Middle Eastern investors remained skeptical of the businesses from the former Soviet Union countries. Its detrimental effects are still being felt (Baidaulet, 2019: 22). To summarize, the above mentioned instances show that, unlike other countries, Kazakhstan has had practical experience in Islamic financial dealings

since its independence, in addition to the special laws and regulations it has enacted to develop the Islamic financial industry.

Phase 2: Enactment of special laws and regulations, and establishment of new IFIs

The second phase of Islamic finance development in Kazakhstan began in 2009, following the passage of a specific banking law. The Kazakh government sought to encourage local companies to establish Islamic financial institutions by making the necessary changes. The 2008 global financial crisis, however, hindered local businessmen from venturing into a new industry. Soon after, Al Hilal Islamic Bank was set up in 2010 under the auspices of the United Arab Emirates and Kazakhstan (Bekkin, 2010: 269-270)

Founded in 2003 as a result of a partnership between the local and foreign investors (Al Hilal Islamic Bank is one of its shareholders), as well as ICD, the second Islamic finance institution, the Kazakhstan Ijara Company, started its operations in the form of a leasing enterprise (KIC, n.d.). Later, in 2017, a new Islamic leasing company called al-Saqr Finance JSC emerged in the local market. Between 2000 and 2016, the company used to offer conventional leasing services before rebranding as an Islamic leasing company (Al Saqr Finance, n.d.).

Soon after, the second Islamic Zaman Bank was founded paving the way for the conversion of conventional banks into Islamic institutions. The gradual changeover began in 2013, but gained traction that year after the ICD became a shareholder. Later, in 2015, a law was passed allowing the conversion of conventional banks into Islamic. Zaman Bank was eventually registered as an Islamic bank in 2017 (Zaman Bank, n.d.). Currently, four Islamic financial institutions operate in the domestic market. According to AIFC (2020), recently, the Qatar's Al Rayan Bank showed its interest in entering the Kazakhstani market to provide services in Islamic finance and retail banking.

Phase 3: Endorsement of Islamic Finance Master Plan for the Republic of Kazakhstan 2020-2025

Islamic Finance Master Plan for the Republic of Kazakhstan 2020-2025 was prepared by Malaysia consulting company, ZICO Shariah, under the technical assistance of IsDB. The master plan's main goal is to facilitate the growth of Islamic finance assets in the country and reach 3-5 percent of total financial assets within five years, from 2020 to 2025. (ZICO Shariah, 2020).

The proposed actions can be divided into two levels: leveraging the AIFC's potential to attract new players, and enhancing regulation within the jurisdiction. The first set of actions focuses on the AIFC's development and, as a result, Kazakhstan's role as a regional hub for Islamic finance. To achieve this goal, the AIFC should extend its global and regional investor base and liquidity, strengthen cross-jurisdictional cooperation, and establish itself as a reference point for the development of Islamic finance and the related standards. Meanwhile, the second set of actions include the proposal for allowing conventional banks to open Islamic windows through which they would provide Islamic financial services. In order to boost competition and market depth, the plan also recommends to cover Islamic banks under the deposit insurance system and lower the entry requirement (threshold) for new financial institutions.

It provides comprehensive policy recommendations and outlines implementation plans in such segments of Islamic finance industry as Islamic banking, capital market, insurance (*Takaful*) and reinsurance (*Retakaful*), non-banking institutions, Islamic social finance, Fintech, Halal sector, as well as education and training in Islamic finance. (ZICO Shariah, 2020: 48-49).

Results and discussion

Formation of the legal framework for Islamic banking and institutional initiatives

Following the 2008 global financial crisis, Kazakhstan sought alternative sources of financing. The Kazakh government was drawn to the resilience of the Islamic banking system during that crisis. Hence, in 2009, Kazakhstan drafted a legal framework for the Islamic financial institutions and had follow-up amendments to the law.

The first step was taken in 2009, when the government passed legislation titled "*Amendments to laws of the Republic of Kazakhstan aimed at incorporating Islamic banks and regulating their activities, as well as establishing an Islamic financial system*" (Amendments to laws of the Republic of Kazakhstan aimed at incorporating Islamic banks and regulating their activities, establishing Islamic financial system, 2009). Some researchers believe that Kazakhstan had borrowed the Malaysian expertise in developing a legal framework for Islamic finance because, unlike others, the Malaysian model was seen as more viable. The process of drafting the bill began in 2008 engaging the experts from Malaysia, the United Arab Emirates, and IsDB (Shuptybayeva, 2014: 107).

The amendments to the Banking and Banking Activities Law of the Republic of Kazakhstan were critical in facilitating the establishment of Islamic banks in Kazakhstan (The law on Banks and Banking Activity in the Republic of Kazakhstan, 1995). The revisions to this legislation addressed obstacles hindering the growth of Islamic banking industry, specified the prerequisites for incorporating Islamic banks, set out the regulations governing their operations, and formalized the liaisons with the national regulatory agencies. Furthermore, the changes endorsed a list of financial products and provided brief definitions for each of them. The following Islamic finance contracts were specifically covered by the new law: *Mudaraba and Musharakah* (partnership arrangements), *Qard Hasan* (interest-free loan), *Murabaha* (cost-plus sale), *Ijara* (leasing), *Wakala* (agency) and *Wadia* (safekeeping).

As the second stage in building the legal framework for Islamic finance, a legislation titled "*Amendments to some legislative acts aimed at establishing Islamic finance*" was enacted on July 22, 2011 (ARDFM, n.d). This law aims at regulating the securities market and specifies the obligations of the issuers. It specifically outlines a procedure for issuing investment fund shares and regulates Islamic leasing and participation certificates, along with other securities stipulated in other Kazakh laws. The adoption of amendments to "Securities Market and Investment Funds Laws" paved the way for Islamic securities to be listed on the Kazakh Stock Exchange.

Legislative efforts pertaining to Islamic insurance schemes were initiated in 2009, as it was recognized that the Islamic finance industry would be incomplete without properly functioning Islamic insurance sector. Taking into account this fact, the AFR and the Almaty Regional Financial Center (ARFC) jointly drafted a bill on Islamic insurance (Ryskulov, 2010: 1). As a result, the government adopted a law "*Amendments to some legislative acts of the Republic of Kazakhstan concerning insurance and Islamic finance*" on April 27, 2015 (Amendments to some legislative acts of the Republic of Kazakhstan concerning insurance and Islamic financing, 2015). The law introduced the concept of Islamic insurance and its regulations. Moreover, the government amended legislation governing Islamic banks and leasing companies. To be specific, the legislation was revised to facilitate for the provision of Islamic banking products such as *Tawarruq* (The law refers it to as "Islamic financing with involvement of Islamic banks for

individuals and legal entities as merchant broker with follow-up sales of goods to third persons”). On November 24 of that year, the government enacted a law permitting conventional banks to convert into Islamic banks (National Bank of Kazakhstan, 2017).

Legislative measures pertaining to Islamic finance were undertaken along with institutional initiatives. The first Islamic insurance company, called *Takaful*, was incorporated in 2010. It was Kazakhstan’s first foray into the Islamic insurance industry. In the same year, *Takaful* served 600 clients. However, the company’s services were limited due to the absence of a regulatory framework at the time (Yeldesbay, 2019). Following the adoption of the Islamic insurance legislation in 2015, the institution ceased its operations, as its chapter capital did not meet the legal requirements.

The Islamic finance industry of Kazakhstan has witnessed a number of significant events, including the first issuance of Islamic bonds (*Sukuk*) by the Development Bank of Kazakhstan (DBK) amounting to 76,7 million US dollars in 2012; the endorsement of Islamic Finance Master Plan by the government aiming at substantial growth of the industry by year 2020; the National Bank of the Republic of Kazakhstan (NBRK) becoming an associate member of the Islamic Financial Services Board (IFSB); and the NBRK opening a department to develop Islamic finance. In 2014, Kazakhstan received technical assistance from the IsDB to boost the growth of Islamic finance industry through legislative acts. The same year, the NBRK became a supervisory member of two international standard-setting organizations: Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Islamic Financial Market (National Bank of Kazakhstan, 2017).

The establishment of AIFC in July 5, 2018, as a part of the “*National plan – 100 specific initiatives aimed at implementing five industrial reforms*”, was a crucial factor inspiring the Islamic finance in Kazakhstan. It was modelled after the Dubai International Financial Center; and one of its key pillars is promotion of Islamic finance in Kazakhstan.

Nonetheless, the undertaken reforms and initiatives are insufficient for Islamic financing to thrive in Kazakhstan. The *Islamic Finance Master Plan – 2020*, approved by the Kazakh government on March 29, 2012 failed to meet its objectives, namely its clause No.371. The master plan had set a target to increase the ratio of domestic Islamic finance assets against total assets by up to 3-5 percent by year 2020 (Gridneva, Sarybayeva, 2019: 25-27). However, that indicator did not even make one percent today.

According to Kazakh experts, the master plan did not designate milestones with the particular dates, nor did its numerous paragraphs identify the responsible state agencies and funding sources. As a result, tasks outlined in the master plan were not delivered on time; relevant state agencies formally submitted quarterly reports on work progress. Despite several legislative measures, the legal framework of Kazakhstan remains unsystematic and uneven, impeding the industry’s growth. Implementing the adequate legislative reforms is impossible with weak legislation, which is based on the *case-by-case* principle (Baidalet, Salikhova et.al. 2014: 250). According to Maggs (2011: 370), the “*modern Islamic Banking and finance legislation has originated not bottom-up from the Islamic faithful, but top-down from multinational businesses seeking a profitable market position*”. The existing flaws in Islamic finance regulations are likely hindering the development of Islamic finance.

Following the failure of the previous master plan, Kazakhstan approved the new 2020-2025 master plan to facilitate Islamic finance (ZICO Shariah, 2020). This plan was prepared by the Malaysian ZICO Shariah Advisory Services, with the assistance of the Islamic Development Bank. It intends to raise the share of the Islamic finance industry in the domestic market by 3-5 percent by 2025. Before drafting this master plan, ZICO Shariah Advisory Services thoroughly examined the Kazakh legislation as well as the specifics of the market. They listed several factors impeding the development of Islamic finance in Kazakhstan and proposed follow-up remedies. So, to increase the share of Islamic banking domestically, it necessitates taking the following actions:

Allowing conventional banks of Kazakhstan to open and operate Islamic windows by introducing a special regulatory and prudential regime. The AIFC is expected to set a framework that permits opening the Islamic banking windows from any jurisdiction;

The inclusion of Islamic banks into the Deposit Insurance Scheme;

The establishment of an Islamic Finance Department within the organizational structure of the regulatory authorities;

Lowering entry barriers for new players to add diversity and depth to the market by incorporating a broader range of licenses for Islamic banks according to a bank’s category;

Expanding products eligibility to add a depth to the market;

Establishing enabling infrastructures to promote stability and sustainability (ZICO Shariah, 2020: 48).

These recommendations are expected to give impetus to the growth of Islamic finance industry in Kazakhstan. In this regards, foreign experts claim that Kazakhstan owns solely two Islamic banks to this day because of rigorous legal requirements in place. ZICO Shariah Advisory Services specialists emphasized that the minimal charter capital requirement for a commercial bank, as determined by the Kazakh banking legislation, is much higher compared to other countries. According to the Banks and Banking Activities Law, a bank (conventional or Islamic) must have 26.2 million US dollars in charter capital. Taking into account other costs, incorporating a commercial bank in Kazakhstan will require at least 30-35 million US dollars. If the expenses to enable sustainable banking operations for the first three years are needed, the 35 million US dollars will be insufficient. As a newly formed bank will not have a large customer base during the first three years, 50 million US dollars may be sought. This challenge is faced by any Islamic financial institution willing to enter the Kazakh market.

Accordingly, the master plan recommends to relax the requirements and conditions for registering a new bank and allow opening *Islamic windows* by commercial banks. These measures are expected to increase the share of Islamic finance industry in Kazakhstan. In a country with a lack of infrastructure for Islamic finance, it is significantly risky to incorporate a new Islamic bank. On the other hand, opening an Islamic window does not pose that much risk, nor does it demand large financial investments. The foreign experts made a similar proposal with reference to the successful experiences with Islamic windows in Malaysia and the United Kingdom (ZICO Shariah, 2020: 48-49).

According to Thomson Reuters, CIBAFI (Council for Islamic Banks and Financial Institutions) and IRTI (Islamic Research and Training Institute) (2016: 103) ICD Islamic Finance Development Report, 80% of the global Islamic financial assets are related to retail consumers. It implies that a country seeking to develop Islamic finance in its domestic market, should concentrate on retail services. Foreign analysts believe that, under the existing circumstances, Kazakhstan would rather promote the creation of Islamic windows by the conventional banks with a stable clientele, than incorporating full-fledged Islamic banks (ZICO Shariah, 2020: 48-49). However, governance mechanisms and strict regulations are required to open Islamic windows by conventional banks. For this reason, the Master Plan 2020-2025 suggests legislative amendments permitting conventional

banks to open Islamic windows and tools to regulate their operations. The proposals in this Master Plan create equal opportunities both for conventional and Islamic banks (ZICO Shariah, 2020: 49-53).

For the steady growth of the Islamic finance industry there is a need to develop an adequate human capital. Currently, Kazakhstan experiences a shortage of local professionals and experts with in-depth knowledge of Shariah norms in general, and Islamic finance in particular. The local Islamic financial institutions, such as Zaman Islamic Bank, Saqr Finance, and Kazakhstan Ijara Company, have outsourced the Sharia audit and review functions to foreign service providers to ensure the compliance of operations and products with the Shariah norms and principles. The financial institutions incur substantial costs by inviting foreign specialists. In addition to the hefty compensation paid to foreign experts, the banks bear significant costs for translation of their internal documents into a foreign language. Moreover, the translation process is time-consuming. The foreign experts demand a precise translation of the bank documents in order to certify Shariah conformity. Members of the Shariah board do not understand either the Kazakh or Russian languages in which the documents are written, making their task less efficient. In other words, such a circumstance raises the prospect of Shariah incompatibility. Therefore, it is critical to have local professionals who can be serve on Shariah boards of local Islamic financial institutions (Stambakiyev, Kahf, 2020).

As noted earlier, the growth of Islamic finance is dependent on the demand of the local community. According to statistics, 70 percent of Kazakhstanis profess Islam (ZICO Shariah, 2020:13). Gridneva and Sarybaeva (2019: 27) claimed that the Kazakhstan's Muslim population will be a driving factor for Islamic finance. In contrast, the foreign think tanks Thomson Reuters, CIBAFI, and IRTI (2016: 98-106) administered a social questionnaire in Kazakhstan in year 2016, the results of which demonstrated the residents' ignorance about Islamic finance. 70% of the survey's participants stated they had never heard of Islamic finance. 41% of them wished to learn more about Islamic finance, while 25% of respondents claimed that Islamic bank operations are not entirely compliant with Shariah norms and principles. These latter responses may be related to lack of understanding of the principles of Islamic financial system and its peculiarities. In other words, the social surveys conducted by foreign think tanks revealed that the local community was uninformed of Islamic finance; and those who were aware of it did not completely comprehend it.

The reality is that the awareness indicator is now a low level. According to Islamic Finance Development Indicator, Kazakhstan is less knowledgeable of Islamic finance than its neighbors Kyrgyzstan, Uzbekistan, Turkmenistan, Tajikistan, and Azerbaijan (IFDI Refinitiv Thomson Reuters, 2020). Undoubtedly, Kazakhstan is far ahead of the above-mentioned countries in terms of legal framework and infrastructure, but the country falls behind in terms of awareness. This indicates the lack of effective initiatives aimed at educating the Kazakh people about Islamic finance. Given the economic principle that “*demand generates supply*”, a proactive awareness campaign is essential to educate locals with the fundamentals and peculiarities of the Islamic finance industry.

Conclusion

Kazakhstan is a pioneer of Islamic finance in the Central Asian region, which has been supporting the relations with Islamic financial institutions since its independence. The country drafted the related bills and built the necessary infrastructure for Islamic finance industry back in 2009. This was a turning point; the adoption of an Islamic banking law delimited the history of Islamic finance in Kazakhstan to pre- and post- periods. The pre-period is distinguished by the proactivity of the local business community in introducing Islamic finance without having the adequate legal framework and infrastructure. The establishment of AIFC in 2018 raised hopes that it will help in

boosting Islamic finance in the country. One of the platform’s key pillars is to facilitate Islamic finance by resolving the issues left unsolved by the Kazakh law by means of referring to English law, which is expected to contribute to Islamic finance eventually. The Qatar-based Masraf Al Rayan Islamic Bank is currently in the process of joining the AIFC platform. The entry of new players into the local financial market, as well as the development of retail Islamic finance are crucial to the industry’s success.

According to the research findings, the key factors that impede the growth of Islamic finance in Kazakhstan are a poor legal framework, strict legal requirements for incorporation of a new bank, a shortage of local Islamic finance experts, and a low awareness of residents of the Islamic financial products. Addressing these issues will contribute to the development of Islamic finance in Kazakhstan.

There has been little research into the current state, challenges and opportunities for the development of Islamic finance in Kazakhstan. This article reviews the history of the Islamic financial industry in Kazakhstan, its current position, and the challenges that may obstruct the future growth. It is recommended that a thorough investigation be performed on each of the aforementioned factors hindering the expansion of Islamic finance in Kazakhstan. The publication of various scholarly papers covering all aspects of Islamic finance, as well as the organization of conferences, seminars and workshops of various formats would aid in raising the public awareness of Islamic finance.

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