

International Comparative Legal Guides



Fintech 2020

A practical cross-border insight into fintech law

Fourth Edition

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The State of Fintech in Central Asia: How Kazakhstan Drives the Regional Fintech Industry



Dr Kairat Kelimbetov
The Governor of the Astana
International Financial Centre

Foreword

It is my honour to introduce the exclusive Kazakhstan chapter to *ICLG – Fintech 2020*, a leading platform for legal reference.

Financial technology can facilitate a leapfrog in the economic development of a country. Also, the current crisis caused by the global pandemic shows the need for more flexible and resilient development models and instruments. That, in turn, could be achieved by further digitisation as it is a way to provide better services, reduce costs and increase safety and transparency of the processes in many industries.

This chapter is an initiative for fintechs from all around the world to discover the market of Central Asia. In particular, the Astana International Financial Centre aims to be that platform, where any potential stakeholder can benefit from favourable conditions and advantages of the regional market.

Since regulation, or lack of it, is one of the significant obstacles for fintech development and expansion, we focus on it throughout the chapter. That includes a regulatory framework based on English common law and first in the region fintech regulatory sandbox (FinTech Lab) which safeguard investors while utilising business opportunities of an emerging market.

Rapid tech innovations implemented in the financial services industry put pressure to keep up with regulating newly emerged products and services. Besides being properly regulated and growing digitally, it is also necessary to have industry expertise, tech professionals, and strong entrepreneurial acumen for fintechs to succeed.

I hope that the data, insights, and analytics provided in this chapter give you a thorough outlook for the emerging fintech ecosystem of Central Asia.

Dr Kairat Kelimbetov
The Governor of the Astana International Financial Centre

Introduction

Central Asia (CA), located between two of the world's largest economies, serves as a bridge between Europe and China under the Belt and Road Initiative. As a growing market, CA meets the key factors to become a distinguishable fintech hub on the map of leading financial centres. CA comprises of the countries of Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, which have common geography, mentality and, most importantly, a shared vision for the future.

For CA, fintech has a particularly important role to play as these potential benefits are associated with the regions' goals and strategy. Innovations and underlying technologies contribute to addressing the existing challenges such as large unbanked populations, young entrepreneurs whose growth is constrained by limited access to finance, undiversified economies and bureaucracy. "Harnessing the power of fintech would be an economic

game changer for Kazakhstan and Central Asia", mentioned Christine Lagarde, Ex-Managing Director of the International Monetary Fund.

The World Bank ranks Kazakhstan 25th on its Ease of Doing Business list among 190 countries.¹ It is also worth mentioning access to human capital as this is a fundamental factor for a business and the economy. In Kazakhstan, by the government fully funded programme alone, over 11,000 people attended world-class universities abroad adding to the local talent pool.²

Establishment of the Astana International Financial Centre (AIFC or Centre) was a timely and crucial decision in realising the fintech potential of Central Asia. AIFC offers a special jurisdiction based on English common law and unique regulatory framework, including regulation in fintech. AIFC regulatory sandbox (FinTech Lab) allows fintech firms (both start-ups and incumbents) to test and/or develop innovative solutions in a tailor-made regulatory environment and offer their innovative financial services to the market without being immediately subject to the full set of regulatory requirements by gradually complying with them.

This chapter reviews the fintech landscape, regulatory developments in the CA region, and identifies constraints to the growth of fintech and reviews AIFC's contribution in unlocking potential growth of the industry.

The State of Fintech in Central Asia

Banking penetration remains low for most of Central Asian countries

CA has a total population of over 74 million people, and more than half of the adult population does not have access to banking services.³ About 55.2% of the region's population live in rural areas where financial inclusion is even poorer.⁴ However, banking penetration is gradually increasing due to the development of infrastructure and government cashless initiatives. Nonetheless, a substantial part of the population is still not provided with basic banking products.

Key barriers to financial inclusion are the trust in financial institutions, poor financial infrastructure, high costs of financial services, restrictive regulations and financial products offered by banks in major cities that are more suited for an urban population. Almost 30% of unbanked adults in the region stated that their lack of trust in banks discouraged them from opening an account. The deficient level of capitalisation in the region is proof of that.⁵ Less than 25% of people in the area get loans from official entities.⁶ As such, informal borrowing between friends and relatives is a dominant source of financing.⁷ The large unbanked population of Central Asia could make the region opportune for fintech solutions that can attract by providing cheap and easy-to-use financial products and services.

SMEs in Central Asia face barriers in accessing affordable financial services, but fintech can fill the gap

SMEs' shares in Central Asia are limited to relatively low figures. In Kazakhstan, for example, SMEs account for only 23.1% of the gross domestic product (GDP).⁸ In the Kyrgyz Republic, SMEs produce 12% of the national GDP.⁹ However, SMEs carry the potential for catalysing the substantial economic development and diversification of the region.

Since Central Asian states have only recently embarked on the adoption of fintech tools, the hampered access to cheap financial services restrains the SMEs' development. The asymmetric information and high transaction costs are the primary reasons why lenders are cautious about financing SMEs.¹⁰ High collateral requirements and tight credit conditions also discourage SMEs from applying to loans.¹¹

Fintech solutions, therefore, could improve the SMEs' access to financial services and create incentives for their higher efficiency. A few examples of Central Asian fintech start-ups that are already in the market with real customers include:

- Marta, a mobile acquiring service for SMEs without an internet connection. It offers a mobile terminal which can be linked with a smartphone and accept payments with Visa, MasterCard and UnionPay cards;
- reKASSA, a fiscal cash register in a free smartphone app; and
- LendingStar, a financial platform where SMEs can sell their receivables and get low-cost financing for their operations.

Mobile and internet banking is on the rise

Internet access has grown significantly in the region over the past few years. CA's average Internet penetration rate is estimated at 49% in 2019 but with significant variations between the countries. The level of penetration in Kazakhstan is above 79%, while indicators in Tajikistan and Turkmenistan make up only 26%.¹² Internet penetration in the Kyrgyz Republic and Uzbekistan is around 50%.¹³ Kazakhstan is among the countries with the highest level of internet and smartphone penetration (64.9%) in the region.¹⁴

Banks are leveraging mobile and internet banking to provide greater financial access in remote and rural areas. Average mobile access in these countries is more than 60%.¹⁵ Low access to the formal financial sector but high and increasing mobile and internet penetration provide a massive opportunity for fintech companies in the region to offer financial services to traditionally underserved segments.

In 2019, the volume of digital payments in Kazakhstan increased by 2.3 times and amounted to about 34.9 billion USD.¹⁶ The growth was due to the development of the infrastructure of trading POS-terminals, the entry of Apple Pay and Samsung Pay to the markets of Kazakhstan, further encouragement for cashless payments bonuses and cashback, as well as the active use of cashless payments on all types of public transportation.

Volumes of the e-commerce market have been steadily expanding in the region with the rates of internet and mobile penetration increasing and digital payment infrastructure hence being widely improved. Leading in the rates of internet penetration, Kazakhstan has the largest e-commerce market in the region, equal to 2,143.4 million USD. The market of Uzbekistan totals 643.9 million USD. The Kyrgyz Republic is less compatible with e-commerce market levels at 162.8 million USD. Tajikistan and Turkmenistan, lagging far behind in internet penetration levels, with 54.7 and 81.5 million USD, respectively, account for the smallest e-commerce markets in the region.¹⁷

Payment segment has dominated initial fintech innovations in the region

Except for Kazakhstan, CA countries are in the early stages of their digital journey. According to the Agency for Regulation and Development of the Financial Market of the Republic of Kazakhstan, the most popular fintech segment is payments.¹⁸

The entire region's fintech innovations have focused on retail payment instruments as well. For example, electronic wallets (e-wallets), that are sometimes linked to cards and mobile phones, can be used as a form of payment, to withdraw cash, to pay bills, make deposits, and send or receive money transfers. Innovations that have potential to improve financial inclusion, such as mobile financial services for unbanked populations, RegTech (credit scoring, risk management, and regulatory compliance), trade processing, Market Place Lending (MPL) and crowdsourcing are either in the nascent phase or are yet to emerge.

Regulation by countries

Uzbekistan

Uzbekistan adopts new regulations to facilitate the creation and implementation of digital technologies. In particular, the recent Presidential Decree "**On the measures for further development of the circulation of crypto assets in the Republic of Uzbekistan**" enabled the creation of the **National Mining Pool and the regulatory sandbox "Uzbekistan Blockchain Valley"**.¹⁹ The initiatives to create the pool and the sandbox came from the National Agency of Project Management, the Central Bank of Uzbekistan, the Ministry of Development of Information Technologies and Communications, and the Ministry of Energy.²⁰

From February 1, 2020, all small or individual miners in Uzbekistan should sign up in the national mining pool, the goal of which is to bring together all domestic crypto market participants bound to pay the membership fee. The contribution would pay off with preferential electricity rates. All large (industrial) mining companies are to register with the regulatory sandbox and acquire a licence. The valley will give the entities a chance to test their innovative financial products and services with no regulatory risks.²¹

Uzbekistan assigned a legal status to blockchain and cryptocurrency in 2018. The Uzbek citizens were banned from buying and using digital money for domestic payment transactions until this year. On January 20, 2020, the National Agency for Project Management, in close cooperation with the Korean Blockchain Business Association (KOBFA), opened the new platform for a licensed crypto exchange named the **Uzbekistan Cryptocurrency Exchange (UzNEX)**.²² The UzNEX offers powerful Application Programming Interfaces (APIs) for safe and convenient digital coin trading.

Moreover, the Decree of the President of the Republic of Uzbekistan "**On additional measures to improve the mechanisms for financing projects in the field of entrepreneurship and innovation**", signed on May 5, 2018, provides favourable financial incentives for venture investors and start-ups. Based on the document, investment and management companies are subject to no licensing. Created venture funds that co-finance high-tech entrepreneurial and high-tech start-ups co-financed from venture funds will be exempt from all types of taxes and mandatory payments for several years, except for a single social payment.²³

Last year, the Government announced the launch of the IT-Park venture fund. The mission of the IT-Park is to create an affluent environment for supporting, nurturing and growing IT start-ups

in Uzbekistan. The fund aims at accumulating 10 million USD investments from state funds, international financial institutions, foreign investment companies and interested private investors. The IT-Park will allocate from 25,000 USD to 100,000 USD to each project depending on its development stage. The venture fund has already embarked on building partnerships with international venture parties such as QazTech Ventures (Kazakhstan), Sturgeon Capital (UK), RB Partners (Russia), Aleinikov and Partners (Belarus) and Global Venture Alliance (USA).²⁴

The Kyrgyz Republic

The Kyrgyz Republic has set its path on the adoption of digital technologies initiating the payment sector participants to look for ways to increase their competitiveness and efficiency, and **the regulator** to create favourable conditions for the development of digital interaction and its safe, reliable and efficient implementation.

There are currently no official regulations protecting fintech initiatives in the Kyrgyz Republic. However, the National Bank has recently published “The Concept for the Development of Digital Payment Technologies in the Kyrgyz Republic for 2020–2022” dated February 4, 2020, which implies the introduction of numerous novel digital technologies and their regulation.²⁵

The National Bank, the Commerce Bank, and the Interbank Processing Centre are to execute the introduction of contactless technology to conduct payments in cashless form, along with the creation and development of a market-place platform for payment services and products based on the Interbanking Processing Center (IPC), and shift to the ISO 20022 “Financial services. Universal Financial Industry Message Scheme” international standard.²⁶

Under the mandate of the Kyrgyz regulatory body, i.e. the National Bank and the state law enforcement agencies, the following is in the process of accomplishment:

- the development and approval of the regulatory legal acts on the initiation of innovative payment business models, processes, products and services;
- the development of common standards for data exchange (Application Programming Interface); and
- the development of licensing mechanisms and regulating activities related to the circulation of digital (virtual) assets (cryptocurrencies).²⁷

Tajikistan and Turkmenistan

The financial systems of Tajikistan and Turkmenistan are still not technically ready for the implementation of new digital technologies.

Tajikistan is currently putting effort into modernising its payment system’s laws and expanding financial inclusion with the assistance of the World Bank and the United Nations Development Programme (UNDP). The country has made several attempts to employ blockchain in money transfer.²⁸

There is an acute insufficiency of available information on Turkmenistan’s activities in the field.

Fintech Development and Regulation in Kazakhstan

Kazakhstan is developing its policy towards the fostering and development of a digital economy and innovations. The “Digital Kazakhstan” state programme envisages the development of the economy through the diversification and development of alternative financing strategy engaging the fintech.

Astana International Financial Centre

Aimed at developing financial and professional services and facilitating foreign investment, AIFC, the English language common law jurisdiction, was established in 2018. Over 430 local and international companies have registered on AIFC’s site as of April 8, 2020.

AIFC’s financial services regulator, the Astana Financial Services Authority (AFSA) pursues fostering financial innovation in AIFC and the wider region and strives to establish a favourable regulatory environment for fintech enterprises. AFSA is independent of the Kazakhstani financial regulators, i.e. the National Bank of Kazakhstan (NBK) and the Agency on Regulation and Development of the financial market of Kazakhstan (Financial Agency).

Within AIFC, there are dispute resolution authorities such as AIFC Court and International Arbitration Centre, guided by best practice in resolving civil and commercial disputes. AIFC, in partnership with Nasdaq and Shanghai Stock Exchange, has created the Astana International Exchange, a high-tech infrastructure for the convenience of participants and the development of the stock market. Goldman Sachs and Silk Road Fund have also invested in this venture.

AIFC has advantages such as tax optimisation, a special labour regime, a single-window system for issuing visas, obtaining work permits, etc, all of which make AIFC a transparent and safe environment for international investors and companies doing business in Kazakhstan.

The Centre has a holistic approach to the development of fintech ecosystem by supporting start-ups, delivering attractive conditions for established enterprises to enter the regional market and providing a unique regulatory framework.

AIFC Regulatory Sandbox/FinTech Lab

With the view to support the introduction of innovation to the financial market, in January 2018, AFSA launched the first regulatory sandbox in the region called the “FinTech Lab”, which allow firms to test out and develop the innovative financial products and services under a special regulatory regime with tailor-made regulatory requirements applicable for each individual firm.²⁹ In addition, FinTech Lab participant firms may also obtain individual guidance from the regulator about how the rules apply to new business models and innovative financial services (for more information on the advantages of the FinTech Lab, please follow this link: <https://afsa.aifc.kz/fintech-lab>, and watch the two-minute video).

Two years of effective functioning has proven the FinTech Lab to be a highly popular destination for financial innovators from all over the world. By the end of 2019, there were 25 firms in total accepted to the FinTech Lab from 11 jurisdictions offering seven different types of innovative financial services.

AIFC FinTech Lab post-implementation reviews

Since the deployment of FinTech Lab, ASFA made two post-implementation reviews of rules/guidance applicable to FinTech Lab and introduced several corresponding amendments to the AIFC Acts in March and December 2019 to:

- (1) introduce two FinTech Lab regimes: (1) developing (for licensed firms in foreign jurisdictions to test the local and regional market with minimum resources); and (2) testing (for start-up or incumbent firms to test innovations with real clients and gradually comply with regulatory requirements) FinTech Lab Activities;

- (2) determine testing boundaries and authorisation requirements for FinTech Lab applicants to ensure regulatory certainty on the expected testing boundaries and licensing conditions before obtaining authorisation from the AFSA; and
- (3) address lessons learnt since the launch of the FinTech Lab regime in January 2018.

Regulation of Private E-Currencies in AIFC

In July 2018, the AFSA developed the legal framework to regulate the activities related to operations with **Digital Assets** such as:

- (1) operating crypto-exchanges;
- (2) providing custody of digital assets; and
- (3) Initial Coin Offerings (ICOs).

AIFC Crowdfunding framework

In June 2019, the AFSA with the support of the European Bank for Reconstruction and Development (EBRD) and the leading UK law firm, Clifford Chance LLP, has developed and introduced a regulatory framework for loan- and investment-based crowdfunding platforms in AIFC.

AIFC Framework on the extension of Regulated and Market Activities

In 2019, the AFSA developed and enacted the Framework on the extension of Regulated and Market Activities under which the existing definition of Regulated Activity of Providing Money Services is extended and two new Regulated and three new Market Activities are introduced to the list of regulated financial services by AFSA.

Global Financial Innovation Network (GFIN)

AFSA, jointly with world-renowned regulators including the UK Financial Conduct Authority, Hong Kong Monetary Authority, Monetary Authority of Singapore and others, in January 2019 launched a network of organisations committed to supporting financial innovations in the interests of consumers, called the Global Financial Innovation Network (GFIN).

GFIN seeks to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas on a cross-border basis. GFIN also aims to create a new framework for co-operation between financial services regulators on innovation-related topics, sharing different experiences and approaches.

AFSA, being a full member of the Coordination Group (the governing body of GFIN), offered its support in all three GFIN workstreams, including cross-border testing, collaboration and RegTech, and lessons learnt.

AFSA's plans in fintech

AFSA's priorities in 2020 will include further strengthening of the fintech regulatory environment in AIFC to complement the existing framework and related rules. Upcoming initiatives on the further development of fintech will cover development of the frameworks on e-money and payment services, mobile/digital banking, venture capital financing, IP rights, e-commerce and others.

Start-up support programmes

AIFC Fintech Hub has launched a Fintech Stars Acceleration Program, Visa Everywhere Initiative, and Startupbootcamp Fast Track event in Central Asia. These programmes help fintech start-ups to enter broader markets as they get support from international partners like Seedstars, Visa, Startupbootcamp, etc. Overall, around 120 start-ups have received assistance from AIFC Fintech Hub.

Partnerships

AIFC is continuously working on expanding its presence in the international arena. We have over 50 partnerships worldwide in different areas of fintech as of the end of 2019. AIFC is a patron member of Global Blockchain Business Council (GBBC), the leading industry association for the blockchain technology ecosystem, which brings together innovative organisations and founding thought-leaders from over 50 countries to advance understanding of blockchain technology amongst global regulators and business leaders.

Bitfury Group, one of the top 50 most innovative fintech companies according to Forbes, is a participant in AIFC.³⁰ The company has already opened data-centres in Kazakhstan. Also, at the end of last year, UNDP and Bitfury announced they will work on a project to increase forest areas and enhance forest management practices in Kazakhstan, as well as raise public awareness of climate change and offset carbon emissions attributable to the company by more than 100%.

National initiatives in fintech

Special regulatory regime

In July 2018, by virtue of amendments to the Law of the Republic of Kazakhstan "On the National Bank of the Republic of Kazakhstan", a "special regulatory regime", i.e. a **regulatory sandbox was launched by the NBK**. With the formation of a Financial Agency in November 2019, the competences of both financial regulators of Kazakhstan have been assigned regarding the regulatory sandbox as follows:

- the NBK introduces a special regulatory regime regarding the payment organisations and/or other legal entities not being financial organisations for the purposes of providing payment services and regulates their activities within its remit; and
- the Financial Agency introduces a special regulatory regime regarding the financial organisation and/or other legal entities and regulates their activities within its remit.

The Kazakhstani laws envisage a set of eligibility criteria (such as capability to improve competition in the market, introduce new services and development to the financial market, protect the interests of consumers, etc.) to become a member of the special regulatory regime, which in turn is introduced by virtue of execution of the written agreement between the relevant regulator and the applicant.

Open API

The NBK works on creating **Open API standards and regulations** for commercial banks in Kazakhstan. The NBK, within the framework of the "Digital Kazakhstan" state programme, plans to launch the "Implementation of regulation regarding the creation of open platforms (Open API) in the financial industry" project. It aims to boost competition in the financial market by young fintech-challengers.³¹

The implementation of the project would stimulate fintech companies' development, simplify the procedures of the interaction of customers with financial market participants and fintech companies, and ensure geographic accessibility. The project implies software requirements specification with a description of the interaction between participants, the composition of transmitted data, and examples of transmitted messages.

Venture capital financing

The Government of Kazakhstan pays attention to the development of a **regulatory framework for venture financing**.

Therefore, Law No. 174-VI “On Amendments and Additions to Some Legislative Acts of the Republic of Kazakhstan on Venture Financing Issues” dated July 4, 2018, approved basic concepts like venture financing, venture capital fund, venture manager; as well as the definition of the legal form of funds.³²

A year later, the Government established the **QazTech Ventures JSC**. It is a state company that promotes venture financing tools, venture capital funds support, and best practices and analysis of the venture capital market. The QazTech Ventures signed an agreement totalling 50 million USD with the Singaporean Venture Fund Asia Quest II (QVAF II). The QazTech Ventures will join it as an anchor investor with 10 million USD of capital. According to the agreement terms, the mutually created fund will finance promising start-ups in Kazakhstan and Central Asia during the next three years.³³

The QazTech Ventures also signed an agreement with the 500 Startups, a US-based venture fund. For 10 million USD with further financing of Kazakhstani start-ups, it joined the 500 Startups’ V Global Fund. The total size of the Fund is 150 million USD.³⁴

Overall, the National Bank of Kazakhstan, the Financial Agency and the Astana International Financial Centre are collaborating to develop a joint strategy to foster and enhance fintech in Kazakhstan.

Conclusion

Central Asia is a one-of-a-kind emerging fintech ecosystem. This is due, first, to serving as a connecting point between Europe and China under the Belt and Road Initiative. Second, having such factors as a large unbanked population, growing mobile penetration, limited access to finance, and a great talent pool, etc., that create an immense potential for fintech. Third, solving the regulation obstacle by developing relevant and modern regulatory frameworks and jurisdictions to realise fintech potential and prevent risks properly.

Technology applied to the financial services industry creates solutions that make it easier, cheaper and more transparent for consumers, either a company or an individual, to do business, invest, make payments and get insurance, etc. Demand for fintech increases especially during these challenging times when the world is undergoing an economic crisis and facing the global pandemic. AIFC could be a safe platform for fintechs to grow in the Central Asian region and beyond.

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Astana International Financial Centre (AIFC or Centre) is a special financial zone based on the principles of English common law. Within the Centre, there is an independent financial regulator, dispute resolution authorities and a high-infrastructure stock exchange.

Located in Central Asia, it serves as an essential connecting point between Europe and China. AIFC has such advantages as tax optimisation, a special labour regime, a single-window system for issuing visas and obtaining work permits, etc. All of which makes it a transparent and safe environment for international investors and enterprises doing business in Kazakhstan.

AIFC offers a unique regulatory framework in fintech. The AIFC regulatory sandbox (FinTech Lab) allows fintech ventures to test and develop innovative solutions in a tailor-made regulatory environment and offer their innovative financial services to the market without being immediately subject to the full set of regulatory requirements by gradually complying with them.

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