

CHAPTER III. COMMERCIAL BANKS, THEIR FUNCTIONS AND ACTIVITY ORGANIZATION

SECTION 10. THE PRINCIPLES OF COMMERCIAL BANKS ACTIVITY ORGANIZATION

3.10.1. The legal organizational form of banks

The statutory regulation of banking in Kazakhstan is performed on the basis of legislative and regulatory acts including the Law dated from August 31, 1995 №2444 “About banks and banking activity in the Republic of Kazakhstan” and the Law dated from March 30, 1995 №2155 “About the National Bank of the Republic of Kazakhstan”.

According to the Law “About banks and banking activity in the Republic of Kazakhstan” (further Law) the bank is a legal entity being a commercial organization which is authorized to perform a banking activity. The official status of bank is determined by the state registration of a legal entity in the ministry of justice bodies of RK and by the license for bank operations conduction presence.

From the point of view of organizational legal form the bank presents a legal entity in the form of Joint Stock Company but the state bank could be found also in the form of state enterprise.

The constituent documents of the Bank. *The Founders Agreement* about the bank foundation shall constitute mandatorily:

- the information about founders including full name and place of location of each of them and also data about their state registration (for legal entities), name, citizenship, place of accommodation and data of document of identification (for individual persons);
- the information about quantity, categories and price of shares placement;

The bank statute shall constitute mandatory:

- the full and short name of bank;
- the data about types and order of the funds’ usage (reserve fund) of the bank;
- the decision tree of the bank’s branches.

The banks are founded in the form of Joint Stock companies. In the quality of name the one is used which is stipulated in bank statute. The name shall contain the word “Bank” or its derivative. All the banks excluding National are prohibited to use the word “National” or its derivatives. All the banks excluding National are prohibited to use in their names the words “National”, “Central” in full or short form in any language. The subsidiary banks shall use in their names the name of parent bank.

The authorized capital stock is formed in national currency in the expense of shares sale which under the placement should be paid by money exceptionally. The authorized capital stock of newly founded bank is paid by the expense of its founders on 50% to the moment of its registration and fully – within one calendar year from the day of registration. The minimum volume of the authorized capital stock for newly founding banks amounts 5.000.000.000 (five billion) tenge.

The bank stock (further capital) of the bank is the volume of bank’s assets net of its value of liabilities where the volume of assets is counting by means of net of from the initial volume of the bank’s assets the sum of required reserves (provision) of granted loans and other assets. The accounting capital treatment, volume of bank’s assets, volume of reserves (provision) of granted loans and other assets are determined by the Financial Inspection Committee of the Republic of Kazakhstan. If the value of liabilities exceeds the volume of assets the bank’s capital is negative.

The bank’s founders or shareholders are been legal entities or private persons – residents or nonresidents of the Republic of Kazakhstan. The state can be the bank’s founder and shareholder only in the name of government and either the local executive boards of the regions and Astana and Almaty cities could be the shareholders of the Bank of Development of the Republic of Kazakhstan. The state

enterprises and organizations in which more than 50% of the investment shares in the authorised capitals or placed shares belong to state cannot be the bank's founders or shareholders.

With the aim of protecting the bank's creditors interests and provision of the banking system of RK stability the authorized body (the Financial Inspection Committee of the Republic of Kazakhstan) has a right in consultation and coordination with the government (in case of the bank's negative volume of capital within the last consequent calendar months) to perform a mandatory buyout of the bank's shares under the condition of their obligatory following prompt realization to a new investor who guarantees the required improvement of the bank's financial situation.

The legal entities – nonresidents of the Republic of Kazakhstan including banks can have ten or more percentages of the bank's voting shares – resident of RK under the condition of their minimum required rating availability of one of the main rating agencies.

3.10.2. The basic functions and principles of banks' activity organization

The whole complex of reasons according to which the business entities follow in the process of their activity are called **principles**.

The first and the main principle of the commercial bank's activity is *the work within the frames of available resources*.

It means that the commercial bank shall provide not only the quantitative correlation between its resources, credit exposures and other assets but also achieve compliance of the bank's assets character to a specific of mobilized resources. First of all it refers to the terms. Thus if bank attracts the resources mainly on short terms and invests them mainly to the long-term loans its ability to answer for obligations (liquidity) appears to be in danger.

The second most important principle is *an economic independence* which correlates to the economic responsibility of the bank for the results of its activity and supposes:

- a freedom of dispose of its own funds and attracted resources;
- a free choice of clients and depositors;
- a free dispose of the bank's inputs.

The applicable legislation gives to all the commercial banks an economic freedom in their funds and profits management. The banking profit which rests in its dispose after payment of taxes is distributed according to the Resolution of the General Meeting of Shareholders. It establishes the norms and amounts of contributions to the different funds of bank and also the amounts of dividends on shares.

According to its obligations the commercial bank responds by all its means and property on which a penalty could be imposed. The whole risk from its operations the commercial bank takes on itself.

The third principle is that *the relations of the commercial bank with its clients are built as ordinary market relations under the contract terms*. Granting the loans the commercial bank follows first of all the market criterions of profitability, risk and liquidity.

the forth principle of the commercial bank is that *the state can perform the regulation of its activity only by means of indirect economic methods but not by the direct administrative in the form of orders*, i.e. without an interference to its operational activity. The state establishes a sort of "rules of game" for the commercial banks following which they independently develop and execute their credit, investment and deposit policy.

In order to manipulate the behavior of banks on the market the regulating bodies can change set rules but they don't have right to give them the direct references regarding the directions and conditions of placement or resources attraction.

The basic functions of banks are considered:

- accumulation and mobilization of monetary capital;
- credit cooperation;
- business settlements and payments conduction;
- creation of payment means;
- organization of paper holdings issue and placement;
- consulting servicing of clients.

The mobilization of temporary available monetary means and their transfer into capital is one of the oldest functions of banks. Accumulated by banks available monetary means of legal entities and private persons from one side bring to their owners profit in the form of interest but from the other – create the base for loan operations conduction. Concentrated savings could be used for different economic and social needs coverage. With the help of banks exactly the monetary means concentration and their transfer into capital happens.

The other main function of the commercial banks is credit cooperation. To direct credit relations between the owners of available monetary means and borrowers the dissimilarity of capital volume offered for loan with necessity in it and also term of capital release with the term on which it is required to the borrower prevents. The genuine credit relations between the capital owners and borrowers are also complicated by the risk of indigency of the last.

The capital owner can be disinformed about the borrower's financial condition. The commercial banks playing as the financial representatives eliminate this problem. Banking credits are directed to different spheres of economy, provide an expansion of production. Stable economy cannot exist without the organized and smoothly running system of monetary settlements. That is why the role of banks in settlements and payments conduction has a great consequence.

The main part of settlements between the enterprises is performed in cashless form. Banks acting as representatives in payments carry out accounts by order of clients, accept money on accounts and maintain records of all monetary takings and withdrawals.

The efficient functioning of payment system in the countries with enough developed infrastructure requires the settlement technology improvement. That's why in such countries the various settlement systems are created. For example clearing systems of the gross commercial banks with a wide net of branches and divisions or giro clearing systems in the form of Joint Stock companies founded by settlements member-banks including central banks.

The settlements are conducted also via the net of correspondent banks when between the banks the mutual relations are established stipulating the correspondent accounts opening. The payments' centralization in banks promotes the circulation expenses decrease and for settlements quickening and increase of payments reliability the electronic settlement systems are introduced.

The main function of commercial banks is their ability to create and destroy money, i.e. increase or decrease the monetary stock. The monetary means formation is directly linked to the banks' deposit and credit activity. The deposit can be created by two means: cash money placement on the client's account or granting credit to the borrower. Whereby the noted operations have a different influence on the monetary stock volume in circulation. Thus if client placed on deposit 100 thousand dollars and ordered to pass them on on-demand account the result of this operation will be the cash balances increase in assets and in liabilities – the deposits increase on this sum.

At the same time the total quantity of money in business stays unchanged because the transfer from cash form onto cashless occurred. The other example: the borrower received a loan of 100 thousand dollars and the bank charged them on a deposit account of client. In result the total quantity of money in business increased on 100 thousand dollars because bank in the process of crediting created new payment means.

However banks are able not only create but destroy money either. It is possible under the borrowers' loans repayment by means of money writing-off from their deposit account. In this case the total monetary stock in business decreases.

Under the credit demand presence the modern emission mechanism allows to widen the limits of monetary emission what is proved by the monetary stock growth in the industrially developed countries. But economy needs an optimal not excessive money quantity in circulation that's why the commercial banks act in the limits of restrictions (mandatory reserves) established by central banks.

The commercial banks perform an emission founders' function executing issue and placement of paper holdings in particular shares and bonds. Whereby the banks have an opportunity to direct savings on productive purposes. The paper holdings market in some manner completes the credit system and interacts with it.

By order of enterprises which need the long-term commitments and apply for shares and bonds issue the banks take on themselves the determination of size, terms of emission, choice of paper holdings' type and also liabilities of their placement and secondary circulation organization. The banks guarantee the issued paper holdings purchase purchasing and selling them on their expense or organizing for it the banking syndicates, grant loans for the shares and bonds buyers.

The liabilities on gross amounts issued by big companies could be placed by bank by means of sale directly to its clients but not on stock-market.

The enough economic acquaintance and possibility of economic situations control allow banks to perform the consulting servicing of clients. Banks analyze the financial activity of enterprises, the condition of their accountance, consider the development strategy and determine possible directions of profits growth.

Performing operations with paper holdings the banks assess a perspective of the new client's shares issue and reality of their placement; consult clients about the choice of firms which are ready to place the new paper holdings. The banks render the following consulting services: from accounts opening and settlement, credit and cash services to recommendations of operations performance on monetary and commodity markets.

The list of consulting services performed by commercial banks in various spheres of their activity could be as follows:

- in the sphere of crediting and settlement – information about the monetary market conjuncture, interest rates movement, conditions and forms of crediting, providing recommendations of credit and settlement servicing of various types of dealings, analysis of cashless settlements organization, development of their improvement variants;
- in the sphere of paper holdings issue and operations with them – data about paper holdings market conjuncture, their rates movement, about paper holdings emitters, explanation of paper holdings issue order and rules of their circulation;
- in the sphere of capital investment – data about construction services market conjuncture, building materials prices, different types of construction / installation activities tariffs, economic efficiency of capital investment making-up, etc.

For the last time the commercial banks faced a serious competition from side of numerous specialized credit institutions and also big industrial corporations which created their own financial companies. However a competition stimulates banks to search the new spheres of activity, increase the number of services offered to clients and improvement in service.

The tendency development of commercial banks' functions widening in modern conditions continues. In order to strengthen their positions on market they actively perform noncharacteristic for banks operations intruding into the nontraditional for them spheres of financial entrepreneurship. Thereby the role of banks in economy functioning increases.

3.10.3. The order of banks' foundation, reorganization and activity termination

The permit of bank opening. Any legal entity or private person has a right to put in to the Financial Inspection Committee of the Republic of Kazakhstan with application of intention to found a bank. The notice is placed on both languages – Kazakh and Russian and should contain the address of applicant.

The application shall have attached documents stipulated by the article 19 of the Law “About banks and banking activity in the Republic of Kazakhstan” and the Rules of permit issue for bank opening and also licensing of banking and other operations, activity on paper holdings market which is performed by banks, adopted by the decision of board of directors of the

Committee for the control and supervision of financial market and financial organizations of the national bank of Republic of Kazakhstan from April 30, 2007 №121:

a) four copies of founding documents (charter, Founders Agreement), copy of foundation meeting protocol all notarially certified and formalized as required by law of RK;

б) data about founders (according to list set by authorized body), financial accounting including consolidated for the last two concluded financial years, audit organization's report about the founders' financial condition;

б-1) documents and data stipulated by the article 17-1 of the Law about banks if the applicant becomes a big participant of bank or bank holding;

б-2) data about conditions and order of bank's shares purchase including determination of sources and means used for bank's shares purchase with an attachment of the confirming documents copies;

в) detailed organizational structure of newly founded bank;

г) business plan adopted by person authorized by founders for documents signing which discovers the strategy of activity directions and scales, financial perspectives (budget, liability balance, statement of profit and loss for the first three financial (operational) years, marketing plan (formation of client base of bank), plan of labour force attraction, risks management arrangement);

д) notarially or any other legally certified document which confirms the applicant's authority of application filing in the name of founders.

The senior officials of bank, organization performing separate types of banking operations are appointed and elected on a seat with consent of the Financial Inspection Committee of the Republic of Kazakhstan.

The mandatory condition of an appointment on senior positions is possession of a higher vocational education in the required field and as a rule they should have employment history in banking system: chairman and accountant-general – not less than three years, their deputies – not less than two years, chief executive officer and accountant-general of bank branch, branch of organization performing separate types of banking operations – not less than one year. The leading officials cannot perform their liabilities more than three months before getting an approval from the authorized body.

The application for permit issue of bank opening should be considered by the authorized body within three months from the day of presentation of the last additional information or document called by the authorized body but not more than six months from the day of application filing.

The authorized body notifies applicant about the adopted decision in written form. A notification is sent to the address stipulated in application for permit issue of bank opening.

The denial of permit issue of bank opening is executed on the grounds of:

a) bank's founding documents are not in conformity with law;

b) bank name is not in conformity with law;

c) size, constitution and structure of an authorized capital stock are not in conformity with law;

d) financial condition unsustainability of the founders;

e) minimum requirements inconsistent of candidates on the bank's senior positions;

f) inconsistency of founding documents of the bank with foreign participation;

The authorized body is obliged to notify an applicant about the basis of refusal in written form.

The state registration of bank is performed by judicial authorities on the basis of permit on opening issued by the Financial Inspection Committee of the Republic of Kazakhstan and data confirming its founding documents affirmation with the authorized body.

Founders are obliged to appeal to judicial authorities for the state bank registration within one month from the day of permit on bank opening getting. After the registration in juridical authorities the bank within fourteen calendar days should file to the authorized body the notarially certified copies of

Founders Agreement and charter with notice and stamp of registered them judicial authorities and the copy of certificate of the bank state registration.

The branch of bank is its division which is not a legal entity locating out of banks residence, performing banking operations in the name of bank and acting within competence conferred to it by bank. The branch has a single with bank balance and also name fully matching with the name of bank.

The bank is obliged to receive an endorsement of its branch opening from the authorized body. The question of endorsement for branch opening should be considered within three months. The question of endorsement for representative opening by the bank-resident of the Republic of Kazakhstan should also be considered within three months.

The denial of representative opening by the bank-resident of the Republic of Kazakhstan is executed on the grounds of:

- 1) fragile financial condition of the bank;
- 2) nonfulfillment of prudential regulation and other mandatory rules and limits within six consequent months which preceded filing of an application of representative opening;
- 3) presence of acting limited measures of influence and sanctions prescribed by law for banks;
- 4) nonpresentation of one of required documents.

The question of endorsement for representative opening by the bank-nonresident of the Republic of Kazakhstan should be considered within three months.

The denial of permit issue of the representative opening by the bank-nonresident of the Republic of Kazakhstan is performed on the grounds of nonpresentation of any stipulated documents.

The cash and settlement department (savings-bank) of the bank is territorially standalone subdivision of bank founded on the basis of permit of the authorized body which is not a legal entity, doesn't have a statute of branch or representative, performing separate types of banking operations on the territory of Kazakhstan.

Opening and closure of branches, representatives, cash and settlement departments (savings-banks) of the banks are performed in accordance with banking legislation.

The will-full readjustment (merger, joining, division, separation, reorganization) of banks could be done by the decision of general shareholders meeting with the permission of authorized body.

The termination of commercial bank activity occurs by means of its reorganization or liquidation.

Merger is a creation of new credit organization with assignment of rights and liabilities of two or more credit organizations and termination of the last.

Joining is a termination of one or more credit organizations with assignment of all their rights and liabilities to the other acting credit organization.

Division is a termination of credit organization with assignment of all its rights and liabilities to newly created credit organizations.

Separation is a creation of the other or several credit organizations with assignment to it (them) a part of rights and liabilities of the reorganized credit organization without termination of the last.

Reorganization is a transformation of organizational and legal credit organization (from LLC to CJSC or OJSC).

Under the bank's readjustment the rights and liabilities transfer to legal successors. In this case the bank statute and state registration book of credit organizations are added with required amendments. All the documents the terms of which didn't terminate are passed duly to legal successor.

A permit application of bank readjustment should be considered by the authorized body within two months from the day of its taking.

The readjusted bank is obliged to inform all its depositors, clients, correspondents and borrowers about the prospective changes within two weeks from the day of receipt of permit for readjustment from the authorized body by means of direct notification and corresponding publication in not less than two national newspapers.

Bank closing down temporarily represents a compulsory conduction of a whole complex of administrative, legal, financial, organizational and technical and other measures and procedures in relation to bank by the decision of authorized body for purposes of its financial condition rehabilitation and work quality improvement.

The bank could become a subject of temporary closing down on the grounds of systematic (over three consecutive calendar months) nonfulfillment of capital adequacy coefficient.

The temporarily closing down regime supposes an appointment by the authorized body on limited term (to one year) of a temporary administration of bank management or temporary bank executive. The bank's closing down is performed at its own expense.

The authorized body decision of closing down conduction can be appealed by the bank's shareholders to court within ten days; the decision appeal doesn't stop the closing down.

The temporary bank administration (temporary executive) is appointed by the authorized body from its officials or persons not being them which correspond to minimal legal requirements.

The authorized body decision of temporary closing down of bank should contain:

- a) bank name and its location;
- b) grounds for such decision;
- c) taking effect and term of temporary closing down;
- d) list of restrictions of activities;
- e) temporary administration's personal composition or temporary executive's surname and first names;
- f) notice to senior bankers to prepare their work report, tax declaration, data about property availability and size and to render these documents to a temporary administration (temporary bank executive);
- g) temporary administration's (temporary executive's) recommendations.

The decision about temporary closing down is published by the authorized body in two printed periodical publications distributed on the whole territory of Kazakhstan.

Within the term of temporary closing down the temporary administration is controlled by the Financial Inspection Committee of the Republic of Kazakhstan.

The bank can be liquidated:

- a) by the decision of its shareholders (if a permit of the authorized body available);
- b) by the decision of court in cases provided for in the legislation of the Republic of Kazakhstan (compulsory liquidation).

The banks' termination including on the grounds of bankruptcy is performed in accordance with legislation of the republic of Kazakhstan with due regard to the statutory requirements.

The bank БАНК on the basis of Resolution of the General Meeting of Shareholders has a right to move a motion to the authorized body about granting a permit on its *private liquidation*. A motion should be considered by the authorized body within two months from the day of duly completed documents acceptance.

Upon receipt of a permit of private liquidation a liquidation commission is created with due regard to the bank's branches and representatives to which the authority is delegated. the commission's activity is controlled by the authorized body.

Upon the permit getting of the private liquidation the bank is obliged to publish an information about this in the official printed issues. The liquidation commission is obliged within seven days upon approval of liquidating balance and report about the bank liquidation to present them to the ministry of justice and the Financial Inspection Committee of the Republic of Kazakhstan.

Under the liquidation termination the commission is obliged to surrender the documents duly for holding them ad acta and notify about it the authorized body.

The compulsory bank liquidation is performed by court according to:

- a) bankruptcy;
- b) revocation of a banking control licence on the grounds stipulated by the legislation;

- c) claim (legal action) of the authorized bodies, legal entities and private persons about the bank activity termination or otherwise at law.

The declaration of bankruptcy. Bank's indigency and insolvency are settled by a conclusion of the authorized body presented to court and composed due to the prudential regulations accounting treatment (and other mandatory to execution norms and limits) of the bank's capital volume.

The bank could be declared bankrupt only by the decision of court. An extrajudicial proceeding of failed bank liquidation by the decision of its creditors and bank itself is not allowed. A possibility of amicable agreement conclusion between the parties in the case of bank bankruptcy is excluded. The decision about bankruptcy recognition of the bank and its private liquidation the court directs to the authorized body.

The liquidation commission passes the copy of the court's decision to the justice institution which performs the state registration of legal entities and to the authorized body. Upon the liquidation conclusion the commission is obliged to surrender the documents duly for holding them ad acta and notify about it the authorized body. The liquidation commission takes measures for the bank's work conclusion and settlements provision with its creditors.

A permission of bank opening has a legal force till the decision of the banking control license granting by the authorized body adoption. The permission of bank opening is subject to return by bank to the authorized body upon the banking control license granting or upon the court's adoption of the decision of banking activity termination and also in case of permission revocation.

On August 1, 2009 the following banks were liquidated: JSC "ValyutTranzitBank"(АО «ВалютТранзитБанк»), JSC "Nauryz Bank Kazakhstan" (АО «Наурыз Банк Казахстана»), JSC "Business Bank" (ОАО «Бизнесбанк»), JSC "Kazpochtabank" (ОАО «Казпочтабанк»), JSC "Komirbank." (ОАО «Комирбанк»).

As of August 1, 2015 in Kazakhstan works 34 second-tier banks.

3.10.4. The meaning of banking license

In Kazakhstan the credit organization acts on the basis of special permission – license. There the banking operations are listed which this credit organization has a right to perform and also a currency in which these banking operations can be conducted.

The banking licenses are issued by the authorized body (the Financial Inspection Committee of the Republic of Kazakhstan) or by the National Bank within their competence. For the license issue the charges are collected (80 MCI for banking operations; 80 MCI for other operations performed by bank; 30 MCI for broker activity; 30 MCI for dealer activity; 30 MCI for custody activity; 10 MCI for transfer agent activity).

For license getting of banking operations conduction within one year from the day of state registration a newly created bank provides a favourable conclusion of the National Bank about the possibility of license granting in order to conduct the following banking or other operations:

- cash operations: acceptance and withdrawals of cash money including their counting change, exchange, recounts, sorting, packing and holding;
- encashment of the notes, coins and valuables;
- safe deposit transactions: safekeeping services of paper holdings issued in physical certificated form, documents and valuables of client including leasing of cash boxes, closets and rooms.

The condition of license getting of the operations performance of deposits acceptance, bank accounts of private persons opening and conduction is a bank functioning within one calendar year from the day of banking control license receipt.

In order to receive license of the additional banking operations conduction the acting bank should:

- 1) to provide the performance of prudential regulations within three consequent months preceding a request for license granting;
- 2) to perform the requirements set by the Financial Inspection Committee of the Republic of Kazakhstan of risk management and internal audit systems availability;
- 3) to present the rules of general conditions of additional types of banking operations conduction.

The conditions of license getting of activity performance on the market of paper holdings:

- 1) conduction of set for banks by the Financial Inspection Committee of the Republic of Kazakhstan prudential regulations, other liabilities to norms and limits observance over a period of not less than six consequent calendar months preceding the date of license request filing;
- 2) absence of sanctions applied by the Financial Inspection Committee of the Republic of Kazakhstan to bank over a period of not less than six consequent calendar months preceding the date of license request filing.

A required condition of license getting of custody activity is a license of safe deposit transactions performance presence issued by the Financial Inspection Committee of the Republic of Kazakhstan.

The banking control license of national and foreign currency is issued for an unlimited time. However it is not subject of transfer to third persons. All the types of banking operations can be performed only under the direct reference in license availability to the right of their conduction.

The decision of banking control license granting is published in the official periodicals of the authorized body or the National Bank. The copy of license duly certified is subject of general view taking the most available for bank clients place.

The denial of its issue occurs in the following cases:

- a) nonfulfillment of any requirement set for license getting;
- b) if bank will not request for license granting within a year from the date of state registration.

The comprehension questions

1. *What do the banks present from the organizational legal forms point of view?*
2. *List the main functions of the commercial banks.*
3. *What principles of banks' activity organization do you know?*
4. *What is the order of banks' activity creation, reorganization and termination?*
5. *List the conditions of the bank license getting.*