

## Bank Insolvency in Kazakhstan

September 1, 2009

### I. Background

BTA Bank and Alliance Bank, two of Kazakhstan's four largest banks, have been in international headlines for almost a year due to their precarious financial positions. It can be said that these banks still exist today only because of the Kazakhstan government's "too big to fail" policy toward them.<sup>1</sup> The Kazakhstan government has now imposed a deadline on BTA Bank to complete its debt restructuring by September 18, 2009, notwithstanding the negative impact on the country's reputation in the eyes of Western investors.<sup>1</sup>

It has become apparent to the Kazakhstan government that the current legal framework surrounding the insolvency of banks does not provide adequate tools to restructure the financial indebtedness of ailing banks without the consent of all (including dissenting) creditors. It is within this problematic context that the Kazakhstan government has taken steps to substantially revise its bank insolvency legislation. A new bill,<sup>2</sup> which came into force on August 30, 2009 (the "Restructuring Law"), has been rushed through the Parliament and is expected to allow the state to quickly restructure the debt of a distressed bank and bind dissenting creditors.

This client alert will provide the reader with a brief overview of the current legal framework surrounding the insolvency of banks and the changes to the legal framework which may come about now that the Restructuring Law has taken effect, including a brief discussion of possible legal issues which may affect the interests of Western creditors.

### II. Current Bank Insolvency Legal Framework

Currently, there are four statutory regimes to deal with an insolvent Kazakhstan bank:

1) Privately agreed restructuring.<sup>3</sup> An agreement is reached between the bank and its creditors without judicial intervention

<sup>1</sup> According to the chairman of the National Bank, 40 percent of the external debt falls on BTA and Alliance bank, and if this debt is successfully restructured the problem of foreign debt of the Kazakhstan banking sector will be solved.

<sup>2</sup> Law of the Republic of Kazakhstan "On the Introduction of Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan regarding Money Payments and Transfers, Accounting and Financial Reporting, Banking Activities and the National Bank of the Republic of Kazakhstan" No. 185-IV 3PK, which was adopted on July 11, 2009 and took effect on August 30, 2009.

<sup>3</sup> It should be noted that this method is not tested so far.

("workout"). Kazakhstan law does not specifically regulate workouts and treats them as private arrangements.

2) Conservation. A special regime to rescue banks (which are deemed to be still viable) at the sole discretion of the FMSA (the financial regulator), subject to certain conditions.<sup>4</sup> Under the conservation framework, management of the bank will be transferred to a "temporary administrator" appointed by the FMSA. The bank may also be granted statutory immunity from the decisions of the Kazakhstan courts, including the enforcement of international arbitration awards (stay of executions). Until now, conservation was a sporadically used insolvency regime, except in cases where it could be used to effect the slow liquidation of a bank.<sup>5</sup>

3) Liquidation. Involves disposal of a bank's assets, distribution of the proceeds to creditors in the order established in art. 74-2 of the Banking Law<sup>6</sup>, and the ultimate dissolution of the bank. It is initiated by court order<sup>7</sup> which results in an automatic stay on creditor executions and other freezes.

4) Judicial reorganization (and rehabilitation<sup>8</sup>). Involves a judicial order to reorganize the distressed bank. Forms of reorganization in Kazakhstan include merger, acquisition, division, consolidation, spin-off and transformation. Judicial reorganization is hardly ever used and is unlikely in the case of BTA Bank and Alliance Bank.<sup>9</sup>

### III. New Restructuring Law

#### A) Judicial Restructuring

The Restructuring Law amends, among other laws, the Banking Law and introduces, *inter alia*, an entirely new chapter and concept to the Banking Law called "bank restructuring," which is broadly defined as a "number of administrative, legal, financial, organizational, technical, and other arrangements and

---

<sup>4</sup> Conservation of a bank can last for not more than one year, and if the bank's financial condition does not improve during the conservation period, the bank can be liquidated.

<sup>5</sup> For instance, "Nauryz Bank Kazakhstan" JSC was placed under the conservation regime before being finally liquidated as a result of a revocation of its banking license by the FMSA.

<sup>6</sup> E.g. unsecured creditors are creditors of the "eight (last) priority" and their claims are satisfied only after settlement of all other creditor claims in a lengthy and opaque liquidation process.

<sup>7</sup> The bank may be forced into final liquidation by the (i) FMSA, (ii) creditors of the bank or (iii) any other duly authorized person, by filing a suit with the relevant court of applicable jurisdiction.

<sup>8</sup> Kazakhstan law provides that certain rehabilitation measures may also be taken within the framework of judicial reorganization.

<sup>9</sup> There were several precedents of judicial reorganizations of Kazakhstan banks which violated banking legislation and where instructions issued by the banking regulator were not performed. In particular, "Kazakhstan Industrial Bank" OJSC was reorganized through its merger with "Almaty Merchandise Financial Bank" OJSC, "Azhi-bank" OJSC was transformed into a credit partnership and "TransAsian Trade Bank" OJSC was reorganized into a credit-deposit partnership.

procedures implemented by the bank according to a bank restructuring plan (the "restructuring plan") to improve its financial situation and the quality of performance". Under the FMSA's oversight and subject to the approval of a specialized financial court, the bank restructuring framework will permit a bank to voluntarily restructure all or part of its indebtedness, with the agreement of two-thirds of affected creditors (*i.e.* the creditor whose debt will be restructured).

A distressed bank (at its own discretion) may apply to the FMSA for judicial restructuring if it is unable to meet its obligations for more than seven calendar days from the date when the obligations are due.<sup>10</sup> Once the specialized financial court's decision to initiate judicial restructuring has taken legal effect<sup>11</sup>: (i) all or certain creditors' claims are stayed (including under loan agreements and bonds) and (ii) stay of executions are triggered. Importantly, the restructuring bank would have to secure the approval of the draft restructuring plan by not less than two-thirds of the bank's creditors whose obligations will be restructured by the deadline stipulated in the court decision.<sup>12</sup>

#### B) Transfer Of Assets/Liabilities

The Restructuring Law also provides that distressed banks may segregate certain assets and liabilities (including deposits) by transferring them to another bank under certain circumstances, for example: (i) during the conservation process (by the temporary administration), (ii) during judicial restructuring as part of the restructuring plan, (iii) if the bank's license has been revoked (by an FMSA appointed manager), or (iv) apparently, by the bank itself under circumstances yet to be defined by the FMSA in subsequently enacted regulations. The Restructuring Law also expands a distressed bank's ability to segregate and transfer assets and liabilities to a special purpose "stabilization bank" established by the FMSA during conservation of the bank. The Restructuring Law provides, rather ambiguously, that such segregation/transfer (whether to an existing bank(s) or a stabilization bank) would require the approval of the FMSA and the bank's creditors.<sup>13</sup>

---

<sup>10</sup> Within seven days after the court decision on the judicial restructuring has come into force, the bank has to inform its creditors by publishing a notice in Kazakh and Russian in two newspapers distributed throughout the entire territory of the Republic of Kazakhstan.

<sup>11</sup> The court decision will, *inter alia*, determine the time period for which the insolvent bank will be placed under the judicial restructuring regime.

<sup>12</sup> If the bank does not obtain two-thirds of affected creditors' votes for approval of the restructuring plan within the time period stipulated in the court decision, the court will cancel the judicial restructuring.

<sup>13</sup> Creditors are notified through public notices published in approved Kazakhstan newspapers.

### C) Creditors' Risks

An initial review of the Restructuring Law raises some potential risks for the creditors of a troubled bank, including:

Once judicial restructuring proceedings have been approved by the court, all Kazakh court proceedings against the distressed bank will be stayed, including any actions by creditors not participating in the judicial restructuring or which have voted against it.

The Restructuring Law permits banks to restructure all or part of their debt. This appears to indicate that a troubled bank, subject to FMSA approval, will have discretion over which debts (*i.e.* pick up obligations towards which creditors) will be restructured. At the same time, it appears that any possible repayment of restructured debt would be paid from the common assets of the troubled bank.

A creditor, whose debt is included in the restructuring plan but has voted against the restructuring plan, will be forced to abide by the restructuring plan if two-thirds of affected creditors have voted for it, and will not be able to file for final liquidation (bankruptcy) during the judicial restructuring proceedings.

The Restructuring Law does not distinguish between creditors of different priorities, regardless of whether the underlying claims are senior or subordinated, secured or unsecured, claims under trade finance or derivatives related transactions, etc.

The Restructuring Law appears to have been specifically tailored to provide a beneficial legal framework for the restructuring of BTA Bank and Alliance Bank.

The Restructuring Law also permits a troubled bank to segregate and/or transfer its assets to another bank, which poses additional risks to creditors:

The law is unclear as to whether the approval of all creditors is required before the distressed bank is permitted to segregate/transfer assets to another bank or just the approval of those creditors whose underlying liabilities will be transferred.

A distressed bank and/or state authorities may be able to strip the distressed bank of "good" assets, leaving some creditors with "bad" assets (*i.e.* preferential treatment of certain creditors).

A creditor may not have a say in an approved segregation and/or transfer of assets if such creditor's debt is not part of the approved judicial restructuring.

This client alert is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

No part of this publication may be reproduced, in whole or in part, in any form, without our prior written consent.

© 2009 Dewey & LeBoeuf LLP  
All rights reserved.

For further information on Dewey & LeBoeuf, please visit [www.dl.com](http://www.dl.com)

The Kazakhstan government bank rescue package, including enactment of the Restructuring Law, appears not to be intended for the protection of foreign creditors, but rather to protect domestic creditors, e.g. depositors, bank employees and, possibly, state-owned companies.

\* \* \* \* \*

The Restructuring Law is unclear on many issues and at this point there is no way to tell how the law will be implemented or interpreted.

*For more information, please contact Aset Shyngyssov at + 7 7272 50 7575 or [ashyngyssov@dl.com](mailto:ashyngyssov@dl.com), or your Dewey & LeBoeuf relationship attorney.*