CURRENCY REGULATION AND CONTROL: CHANGES FOR KAZAKHSTAN

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The National Bank of Kazakhstan has recently released a new draft Law on Currency Regulation and Currency Control in an effort to introduce step legislative changes in the country. The changes proposed by the draft law, if implemented, envisage expanding present currency control requirements, expanding repatriation requirements for financial transactions, and introducing new monitoring procedures.

One change proposed in the new draft law is to broaden the definition of Kazakhstani residents. The current law defines residents as Kazakhstani citizens, foreign nationals who have a permit for permanent residence in Kazakhstan, and all legal entities registered in Kazakhstan who have their principle place of business in Kazakhstan, as well as their branches and representative offices located inside and outside the country.

The definition of a resident under the new draft law excludes branches and representative offices of Kazakhstani companies located outside of the country, but includes the following three new categories:

- *diplomatic and other official representatives of Kazakhstan living abroad;*
- *legal entities headquartered in Kazakhstan;*
- *branches and representative offices of foreign legal entities registered Kazakhstan.*

Under this regime, Kazakhstani branches and representative offices of foreign companies and some foreign SPVs (i.e. subsidiary companies established for financing or other purposes, such as isolating risk from their parent companies by maintaining assets and liabilities separately) would be required to carry out their transactions with other Kazakhstani entities in Tenge. Furthermore, they would be required to register or provide reports of their currency transactions. However, foreign companies with a branch or representative office in Kazakhstan may find it difficult to determine which regime applies to their transactions with Kazakhstani entities without seeking clarification from the National Bank.

The draft law is also somewhat confusing in relation to notification and/or registration obligations for Kazakhstani branches and representative offices of foreign companies. Since branches and representative offices will now be considered Kazakhstani residents, the requirement for registration of their currency transactions will apply to them. The draft law allows for exceptions only for transactions between branches or representative offices and their parent companies. At the same time, Article 12 of the draft law requires Kazakhstani branches or representative offices of non-financial foreign companies to notify the National Bank about their transactions with residents and non-residents in the form of reports established by the National Bank.

Thus, the draft law does not state clearly whether Kazakh branches will be required to register any of their currency transactions or will only be subject to the reporting (i.e. notification) requirement. It is also not clear why the branches and representative offices of foreign companies must report their transactions with both residents and non-residents. We hope the National Bank will clarify these issues either in the subsequent drafts of the law or in its subordinate regulations.

It is worth noting that the funds transferred between a foreign company and its Kazakh branch or representative office, except for the payment of administrative expenses to maintain the office and to pay its taxes, will be considered as "capital flow transactions" (i.e. transactions subject to monitoring by the National Bank). Although Article 9.9 of the draft law states that currency transactions between foreign companies and their Kazakhstan branches or representative offices do not need to register with the National Bank, these transactions should be reported as per Article 12.

Other significant changes in the draft law relate to currency repatriation requirements. The current law requires residents to repatriate (i.e. transfer back to Kazakh accounts) proceeds from their export of goods, works, and services; as well as refunds from import transactions not performed by non-residents. In terms of these transactions, the draft law will prohibit assignment by residents of their rights of claim to non-residents. The proposed law further states that an export or import contract may be subject to additional currency control by the National Bank if it permits a non-resident to fulfill its obligations (e.g. pay for exported goods) two years or more after the Kazakh resident performed its obligations (e.g. delivered the exported goods).

Most importantly, the draft law will expand repatriation requirements to financial loans. Financial loans include: loans, transfers of funds as security, third party financing, and several other types of transactions.

Thus, financial loan agreements under the draft law, which are subject to registration, must contain a requirement that payments to Kazakhstan residents (except for banks) must be transferred to their Kazakhstani bank accounts. This provision may prohibit lenders to transfer funds directly to vendors, construction contractors, or other creditors in financing and re-financing transactions.

Lastly, the draft law states that residents can give interest-free loans, which meet the conditions for registration, to non-residents only for a period of five years, after which residents should ensure repayment to their Kazakhstan accounts.

The effect of expanding the monitoring regime may be reduced if the National Bank increases the thresholds and other conditions for registering transactions and assigning the contract number established by its regulations. However, the National Bank has not yet stated its intention and the draft law, on the contrary, has eliminated application of the registration regime to export/import transactions and financial loans under which payment is outstanding for more than 180 days.

The draft law was also intended to streamline monitoring regimes. However, very few substantive changes have been made, and there are a number of gaps and instances of vague language in the law.

Under the new draft law, a contract number will be assigned to all currency agreements that fall under monitoring requirements. All capital flow transactions above a certain threshold (including export/import transactions) will be subject to registration with the National Bank. The notification regime will apply to the following cases: reports by Kazakhstan banks about resident currency transactions, notifications by residents when they open foreign bank accounts, and reports by Kazakhstan branches and representative offices of foreign non-financial entities about their transactions with residents and non-residents.

Assignment of a contract number to all currency agreements will allow the National Bank to implement automated monitoring for currency transactions and repatriation obligations. Furthermore, expansion of the registration requirement to all capital flow transactions will create a more stringent regime for transactions, including for acquisitions of minor blocks of shares or interests in Kazakhstani companies, derivative transactions, and real estate purchases (for which notification currently may take place after a given transaction, while registration is required before the transaction takes place). Otherwise, the procedures are very similar to those under current regulations.

It is worth noting that the draft law exempts participants in the Astana International Financial Center from the requirement to register and conduct their currency transactions via Kazakhstani banks.

Finally, a positive improvement in the draft law relates to the "special currency regime" (additional temporary restrictions on currency transactions) that may be introduced if there is a serious threat to Kazakhstan's economy. The draft law provides that the special currency regime must not restrict: (a) the performance of obligations by Kazakhstani residents under agreements instituted by non-residents prior to the special currency regime, and (b) transfers by non-residents of their dividends, interest, and other income from deposits and securities.

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