

To our clients and friends

BRIEF OVERVIEW

of the RK Law Dated 27 February 2017¹ Intended to Improve Civil and Banking Legislation and Conditions for Entrepreneurial Activities

On 27 February 2017, Kazakhstan adopted the Law, which amends a number of the RK codes and laws (46 legal acts in total) to improve civil and banking legislation and "conditions for entrepreneurial activities" (according to the title of the Law). The law was put into force starting 12 March 2017, except for certain provisions, which will enter into force at a later date.

Please see below a detailed overview of such legal developments and other novelties, which we deem most significant for business.

1. Void and Voidable Transactions

One of the key amendments comprises division of invalid transactions into void and voidable transactions. The issue of necessity to introduce the regime of void transactions has been put into discussion in Kazakhstan long time ago, and the RK Supreme Court expressly acknowledged in its normative resolution in July 2016 that transactions may be void, although the then RK Civil Code² did not provide for the regime of void transactions. All "vicious" transactions were supposed to be voidable, i.e. they were recognized as valid until their invalidation by court.

The regime of voidness means that it is not required to prove transaction invalidity in court, because its voidness is explicitly provided for by laws. Only in case of a dispute, the transaction invalidity is to be established by court (Article 157 of the revised RK Civil Code).

Our opinion is that the introduction of the regime of void transactions may exert certain influence on business. Specifically, the legislation expressly stipulates that in certain cases a failure to comply with the transaction form or the absence of certain conditions in a contract (or their non-compliance with the conditions established by legislation) serve as the ground for recognition of a transaction as void. Apparently, the probability of a dispute concerning the transaction voidness is low for such cases. Accordingly, an argument concerning certain transaction voidness may be used, for example, by the tax authority in order not to recognize the lawfulness of deducting expenses under such transactions.

The grounds for transaction voidness relevant for business may embrace the transaction orientation to achievement of a criminal purpose, failure to comply with the transaction form, transaction consummation without obtaining a necessary permit or after expiration of such permit, prohibition to a pledgor to bequeath the pledged property and some other grounds (for example, conditions of foundation documents containing certain restrictions for participants / shareholders are recognized as void).

¹ RK Law No. 49-VI "On Introduction of Amendments into Certain Legislative Acts of the Republic of Kazakhstan on Improvement of Civil and Banking Legislation and Conditions for Entrepreneurial Activities" dated 27 February 2017.

² RK Civil Code (General Part) dated 27 December 1994.



Despite the fact that the introduced novelties have served as the basis for lengthy discussions, new wordings of certain provisions of the RK Civil Code cannot be called as successful or clear.

2. Certain Types of Obligations

The amendments relating to the regime of certain types of obligations are mainly focused on the establishment of grounds for voidness of relevant transactions. In particular, the absence of registration and written form of contracts in the intellectual property sphere entails voidness of such transactions. The Law provides for a necessity to register encumbrance of immovable property with rent and sets forth the commissioner's liability in a more detailed manner.

It is worth pointing out that an insurance agreement with respect to property, safety of which is of no interest, was previously declared as invalid. According to the new version of the rule, such agreement may be invalidated by court. The Law contains a similar amendment concerning invalidity of an insurance agreement, when insurance amount exceeds the insured value.

3. Corporate Issues

The important novelty worth paying attention is the establishment of vicarious liability for officers of companies for deliberate or false bankruptcy caused by actions or omissions of the said persons. Since the legislation does not establish the range of officers for certain forms of legal entities, practical application of this rule may probably result in certain difficulties. Nevertheless, this a considerable step made to strengthen liability of officers for improper management or deliberate bankruptcy.

The Law also provides for another novelty. In case of registering a new legal entity (small-scale or medium-scale business entity) via the e-Government website, it is necessary to concurrently file application for the bank account opening and application for conclusion of agreement on mandatory insurance of employees, specifying the contemplated salary fund, number of employees, type of economic activities and class of occupational risk. Since the latter relates to a specific area of knowledge, the website will probably have necessary options to be selected from a list. This rule will be put into force starting 1 January 2018.

The Law introduces mandatory audit of the annual financial statements of a limited liability partnership (LLP) that is a large-scale business entity, provided that there are participants in such LLP holding the participation interest of less than 10%. As per the LLPs referred to the medium-scale business entities, such audit is to be conducted upon request from the participant holding the participation interest of less than 10%.

It is worth paying attention to mandatory statement of quorum before discussing any issues at a general meeting of the LLP participants; otherwise, the decisions made by such meeting will be void.

As per the novelties relating to joint stock companies (JSCs), the Law stipulates that resolutions on conclusion of certain major transactions are to be adopted by the general meeting of shareholders (the general meeting previously adopted resolutions on approval of such transactions). The Law specifies that it is necessary to establish committees of the board of directors and describes in details their competence. The Law establishes that falsification of financial statements entails officers' liability to JSC, and defines the grounds under which a related-party transaction may be invalidated.

As per other amendments, we may distinguish an obligation of a predominant legal entity to publish information concerning acquisition of more than 20% of shares in a joint stock company, prohibition to legal entities to claim for compensation of moral damages, and determination of the content of a model charter by the RK Ministry of Justice.

4. Land Legislation

The amendments introduced into the RK Land Code³ mainly affect the pledge relationships. In particular, the pledged land plots, which passed into ownership of banks and legal entities, which previously were subsidiary banks, are subject to alienation within six (6) months. Once the six-month period expires, the land plots may be taken in accordance with enforcement proceedings. After alienation of the land plot, the property development term is established for a new right holder as the initial term, which is to be determined by local authorities.

5. Civil Proceedings and Arbitration

The Law introduced respective amendments into the Civil Procedure Code⁴ and Arbitration Law⁵.

According to the introduced amendments, the Civil Procedure Code established the term to submit a response to a statement of claim, which is to be submitted no later than 10 business days of the day a defendant receives a copy of the statement of claim.

From now on, the obligation to send copies of the statement of claim and response to the claim to parties and third parties is imposed on courts. The Civil Procedure Code previously imposed such obligation on a claimant or a defendant accordingly.

The Arbitration Law no longer contains the rule on the party's right to repudiate an arbitration agreement before any dispute arises. This rule was most actively criticized by the legal community, since it actually could result in the parties' refusal to select Kazakhstan arbitrations to resolve disputes.

6. Insurance Activities

The Law introduced minor amendments into the Law on Insurance Activities⁶, pursuant to which it is not required to undergo the procedure for obtainment of the authorized agency's consent (such consent is deemed to have been obtained) to acquisition of the status of an insurance holding, major participant of an insurance (reinsurance) organization in cases as follows: (a) in the event a bank conducts reorganization in the form of accession, or (b) in case of an operation involving concurrent transfer of assets and obligations of a bank to another bank in accordance with Article 61-2 of the Law on Banks and Banking Activities; or (c) in case of an operation involving concurrent transfer of assets and obligations between a parent bank and subsidiary bank in accordance with Article 61-4 of the Law on Banks and Banking Activities⁷.

7. Securities Market

There are few amendments to the Law on Securities Market⁸, but they may have negative consequences for creditors of banks and parties to transaction effected on the stock exchange.

The first category of amendments covers application of a special procedure for registration of the transfer of ownership to shares of banks and preservation of the pledge holders' rights in the event one bank accedes to another. The special procedure was initially introduced only with respect to transactions involving accession with the participation of banks, which undergone restructuring procedure (i.e. financial rehabilitation by way of restructuring its obligations to

³ RK Land Code No. 442-II dated 20 June 2003.

⁴ RK Code No. 377-V "Civil Procedure Code of the Republic of Kazakhstan" dated 31 October 2015.

⁵ RK Law No. 488-V "On Arbitration" dated 8 April 2016.

⁶ RK Law No. 126-II "On Insurance Activities" dated 18 December 2000.

⁷ RK Law No. 2444 "On Banks and Banking Activities in the Republic of Kazakhstan" dated 31 August 1995.

⁸ RK Law No. 461-II "On Securities Market" dated 2 July 2003.

creditors); however, pursuant to the amendments, its effect is extended to cover accession of any banks. The key negative point of the above amendments is associated with the extension of the effect of the provision that "actions with shares of the banks being reorganized and shares placed in the course of reorganization are carried out without the pledge holders' consent." In other words, the opinions of the pledge holders of the bank's shares will not be taken into account in case any bank decides on reorganization. As applied to this provision, it is worth mentioning that, although the applicable Article deals with reorganization by way of accession, the literal meaning of the above rule covers any types of reorganizations, i.e. including merger, division and spin-off.

The second category of amendments is about the cancellation of the necessity to obtain the authorized agency's consent (such consent is deemed to have been automatically obtained) to acquisition of the status of a major participant managing the investment portfolio for a bank, which acquired such status as a result of accession of another bank, or as a result of operation involving concurrent transfer of assets and obligations of the bank to another bank in accordance with Article 61-2 of the Law on Banks and Banking Activities. Before such amendments, the said provision applied only with respect to a parent bank in the event of transfer of assets and obligations by a subsidiary bank to its parent bank.

Finally, the last and the most interesting amendment was introduced into Article 88 of the Law on Securities Market. The new paragraph 4 of this Article stipulates that in case of invalidation of a transaction effected on the stock exchange, the parties are not allowed to return everything received under invalid transaction, as it was previously provided for by the RK Civil Code. The only remedy in this case will be the right of the party affected to claim from the party at fault for compensation of losses.

On the one hand, this provision seems to provide more guarantees with respect to inviolability of stock-exchange transactions. However, on the other hand, it obviously violates the rights of concerned and faultless parties, since the process of collecting losses (i.e. money) takes more time in the vast majority of cases and requires more efforts to be exerted, than the process of returning specific securities. Moreover, in case of bankruptcy of the legal entity at fault, the probability to recover losses becomes low. Finally, it is unclear what procedure will be used to define the losses of the faultless party, which, for example, lost its securities whose quotations may significantly vary at different times and whose expected value may significantly exceed current quotations. The impact of this provision on REPO transactions may be even of greater interest. According to the sense of the Article, we may imagine situations where securities transferred into temporary possession as a security against the return of monetary funds will be lost by the owner once and for all.

In light of this circumstance, we would like to get clarifications from the National Bank concerning the purposes pursued by the amendments, especially with a view to objectives declared by the Government to attract investment and foreign investors. It seems that the amendments were introduced in order to effect a certain specific transaction; however, since the conditions of such transaction are unknown to public at large, it is difficult for us to understand the reasons for such amendments or, which is the most important, the impact such amendments will have on other transactions on the market.

8. Banks and Banking Activities

The key amendments to the Law on Banks and Banking Activities relate to the status of an organization specializing in improvement of quality of credit portfolios of second-tier banks, and enhancement of options to transfer assets and obligations between a parent bank and its subsidiary bank.

In particular, the Law contains provisions that the organization specializing in improvement of quality of credit portfolios of second-tier banks and other subsidiary organizations of the National Bank are no longer recognized as a banking holding and major participant of the bank and, accordingly, respective regulatory requirements to banking holdings and major participants of

banks will not apply to them (on an equal basis with the state and the national managing holding). The Law also stipulates that the RK Government will be the shareholder of the above organization.

Based on amendments introduced into provisions on the types of activities permitted to the organization specializing in improvement of quality of credit portfolios, such organization will be able to acquire any assets and bank's rights to claim against third parties, but not only doubtful and loss assets as it was previously stipulated by laws. It will also be able to act as a founder or a shareholder of banks. It is worth mentioning here that, according to the amendments, no consent of borrowers to assignment of the rights to claim to the above organization will be required. Such organization will be able to get financing for its operations from the budget in the form of targeted transfers.

Special provisions on voluntary reorganization of banks by way of accession, which were previously provided only for the transactions one of the parties to which is a bank, with respect to which the restructuring was carried out, now cover reorganizations of any banks.

Likewise, special conditions for operations involving concurrent transfer of assets and obligations from a subsidiary bank to a parent bank, and doubtful and loss assets from a parent bank to its subsidiary bank, which was previously provided for by Article 61-4 of the Law on Banks and Banking Activities only for banks, with respect to one of which restructuring was carried out, now may apply to transactions involving mutual transfer of assets and obligations between any parent and subsidiary banks. If the license of a subsidiary bank, which transferred its assets and obligations, terminates, the said bank may continue carrying out a number of banking operations stipulated in Article 61-4 without such license, and it will not be considered as an "organization carrying out certain types of banking operations" (i.e. it will not fall within the regulation applicable to such organizations).

A subsidiary bank, which transferred its assets and obligations to its parent bank and lost its license to carry out banking operations, may preserve the word "bank" in its name. The limitation period will not apply to the rights to claim owned by such banks. The exception from special conditions for and limitations on acquisition of shares by banks from other banks, financial and other organizations, as well as the participation in capital, provided for by Articles 8 and 11-1 of the Law on Banks and Banking Activities cover the banks, which performed concurrent transfer of assets in accordance with Article 61-4.

9. Environmental Legislation

The amendments to the Environmental Code⁹ cancel the requirement to undergo state environmental expert examination with respect to construction projects (feasibility studies and design and estimate documentation). The environmental expert examination of construction projects and town-planning projects will be conducted as a part of comprehensive extradepartmental expert examination provided for by legislation on architectural, town-planning and construction activities. The said expert examination will be conducted by experts on staff of one of expert organizations who are attested to provide expert services with respect to a certain section (part) of projects in accordance with the procedure determined by the Kazakhstan legislation on architectural, town-planning and construction activities.

10. Subsoil Use Legislation

In light of amendments introduced into the RK Civil Code concerning the legal regime of transactions, respective amendments were introduced into the Law on Subsoil and Subsoil

⁹ RK Code No. 212-III "Environmental Code of the Republic of Kazakhstan" dated 9 January 2007.

Use¹⁰. According to such amendments, void are transactions effected with respect to alienation of the subsoil use right or subsoil use right associated objects without preliminary permit of the competent authority or after expiration of the term of such permit. Moreover, recognized as void are the conditions of pledge agreements or other agreements contradicting provisions of Article 41 of the Law on Subsoil and Subsoil Use ("Procedure for the subsoil use right termination by enforcement").

The updated version of Article 36 of the Law on Subsoil and Subsoil Use no longer has a provision that failure to notify the competent authority within 5 business days concerning the transaction involving alienation of the subsoil use right or subsoil use right associated objects services as a ground for invalidation of such transaction.

The Law on Subsoil and Subsoil Use also provides for additional documents to be submitted by banks to the competent authority in case of acquiring the subsoil use right or subsoil use right associated objects in the course of the bankruptcy proceedings or recovery proceedings against doubtful assets of the bank's debtors.

11. Registration of Pledge of Movable Property

The Law on Registration of Pledge of Movable Property¹¹ is supplemented by the rules regulating the procedure for electronic registration of pledge of movable property via the Unified Register of Pledges of Movable Property, and now contains the concept of the "unified register of pledges of movable property."

The Law sets out in a more detailed manner the duties of the registration authority, State Corporation and pledge holders intended to release from pledge in case a pledgor performs the obligation secured by such pledge.

12. Rehabilitation and Bankruptcy

The amendments introduced by the Law into the Law on Rehabilitation and Bankruptcy¹² provide for establishment by the authorized agency of the minimum and maximum thresholds for the administrator's basic remuneration. The Law also provides for a possibility to pay basic remuneration of the bankruptcy manager for the period for which the bankruptcy proceedings are extended.

The Law clarifies the rule concerning the procedure for notifying creditors about the creditors' meetings.

The Law also clarifies the procedure for determining competence of the meetings of creditors and validity of decisions made by the creditors' meeting. Specifically, the Law stipulates that in order to determine the competence of a creditor's meeting it is necessary to take into account only votes of creditors entitled to vote when the meeting makes a decision, but not the votes of all creditors whose claims were included in the register and were not satisfied as of the date of the creditor's meeting, as it was before. The Law provides for the cases where creditor's claims in the form of liquidated damages (fine, penalty), losses in the form of lost profit and other property and/or financial sanctions are taken into account to determine the number of votes at a creditor's meeting.

The Law secures the bankruptcy manager's obligation to enter into a contract for bankruptcy proceedings with the creditors committee and to prepare an estimate of administrative costs associated with bankruptcy proceedings.

¹⁰ RK Law No. 291-IV "On Subsoil and Subsoil Use" dated 24 June 2010.

¹¹ RK Law No. 254-I "On Registration of Pledge of Movable Property" dated 30 June 1998.

¹² RK Law No. 176-V "On Rehabilitation and Bankruptcy" dated 7 March 2014.

The term for holding the first creditors' meeting by the temporary manager was reduced. The meeting is to be held within a period not later than 20 business days of the date a debtor was declared bankrupt (as compared to the 45-day period previously in effect).

13. Public Procurement

The amendments to the Public Procurement Law¹³ stipulate that acquisition of assets by the organization specializing in improvement of quality of second-tier banks' credit portfolios from legal entities, which previously were banks, and organizations managing distressed assets, which acquired such assets from the second-tier banks as doubtful and loss assets, and the sale thereof are beyond the Law on Public Procurement.

14. Tax Legislation

The amendments to the Tax Code¹⁴ clarified the rules defining the tax implications arising in case of an operation on concurrent transfer of assets and obligations between a parent bank and its subsidiary bank, with respect to which restructuring was carried out, including with regard to writing-off of obligations and reduction of the amount of reserves in the course of operations involving concurrent transfer of assets and obligations between a parent bank and its subsidiary bank.

The Law supplements the rules defining the procedure for registration and de-registration of VAT payers. In particular, from now on, it is possible for CEO of a legal entity to file application for VAT registration in electronic form.

Best regards,
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¹³ RK Law No. 434-V "On Public Procurement" dated 4 December 2015.

¹⁴ RK Code No. 99-IV "On Taxes and Other Mandatory Payments to the Budget (Tax Code)" dated 10 December 2008.