STRUCTURING PUBLIC-PRIVATE PARTNERSHIP PROJECTS THROUGH THE AIFC JURISDICTION

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Nur-Sultan

AIFC

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INTRODUCTION

The Astana International Financial Centre (AIFC) Authority is committed to improving the facilitation of infrastructure delivery within Kazakhstan and Central Asia. This document's main objective is to provide consistency and clarity to the parties and stakeholders involved in a public-private partnership (PPP) project, both private and public sectors alike.

Whom Is This Document For?

This document is designed as a practical tool for PPP practitioners (investors, consultants, representatives of public authorities) faced with the opportunity of structuring a PPP scheme in the AIFC using conventional finance or Islamic finance or a combination of both. The document is also intended to provide PPP practitioners with a high-level understanding of how to effectively use the AIFC's capabilities, enjoy the benefits it offers, and optimally prepare for and successfully implement PPP projects.

In addition, this document may serve as a tool to help identify the most effective type of PPP for a given project and assist readers in making informed decision about the project.

Readers should note that this document should not be substituted for common sense, judgement, and experience. Expert advice should therefore be sought wherever appropriate.

WHY INVEST IN KAZAKHSTAN?

- According to the estimates of the Asian Development Bank, Central Asian countries will have to invest up to US$33 billion in infrastructure development by 2030 to keep up with the growing populations, increasing energy needs, and rapid urbanisation. Kazakhstan is Central Asia's largest country by land area that has serious economic potential and a capacious market (its own population of 18 million people plus access to the markets of member-countries of the Eurasian Economic Union).

- Kazakhstan is an active participant of the Belt & Road Initiative that will entail investments in infrastructure and development projects (e.g., ports, roads, railways, airports, power plants, oil and gas pipelines and refineries) in dozens of countries, worth an estimated US$1 trillion.
- The transportation sector has a lot of potential in Kazakhstan as in the next six years the Ministry of Industry and Infrastructure Development plans to increase the share of toll roads to 45%.
- Kazakhstan is ranked 25th among 190 economies in Doing Business 2020 rating published by the World Bank:

    - **No. 4** for enforcing contracts;
    - **No. 7** for protecting minority investors;
    - **No. 22** for starting a business;
    - **No. 24** for registering property;
    - **No. 37** for dealing with construction permits.

- During the current economic conditions, institutional investors such as pension funds, insurance companies, and sovereign wealth funds look to diversify and seek alternative sources of return. In this regard, infrastructure can provide a defensive element in their portfolios and the potential for predictable cash flows, capital appreciation, and diversification. Investing in PPP projects in Kazakhstan through the AIFC platform may be both profitable and safe.

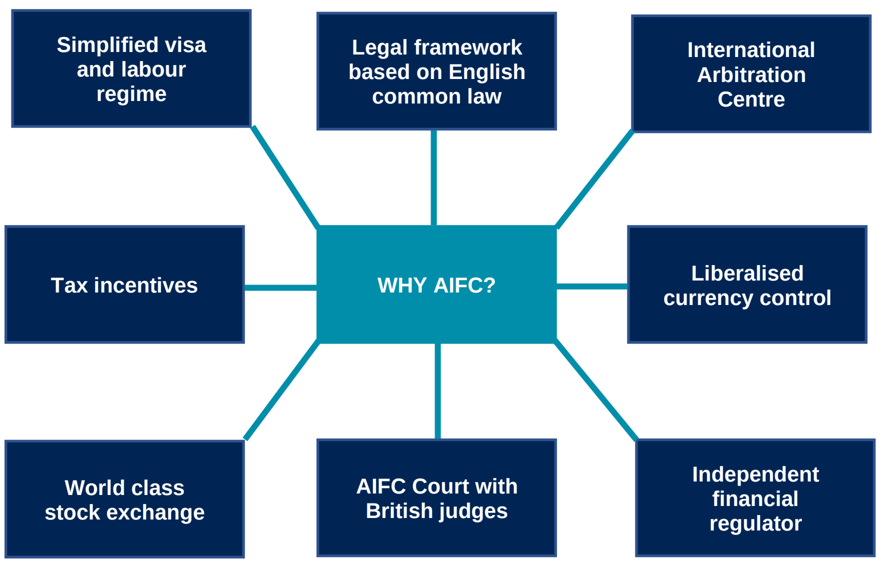
WHY AIFC?

The AIFC is the territory within the City of Nur-Sultan with precise borders determined by the President of the Republic of Kazakhstan where the special legal regime in the financial sphere applies. The AIFC offers a robust legal regime based on principles of English common law; an independent court with leading British judges and International Arbitration Centre; a financial regulator; and a brand-new stock exchange, which was established in partnership with Goldman Sachs, Shanghai Stock Exchange, Silk Road Fund, and Nasdaq.

Business-friendly environment with unprecedented conditions in the entire region makes the AIFC a perfect place to develop your business:

- Liberalised currency control (transactions of registered or recognised companies in the AIFC may be denominated and executed in a currency agreed between them. Trades at Astana International Exchange (AIX) are to be denominated and executed in a currency specified by the Exchange rules);

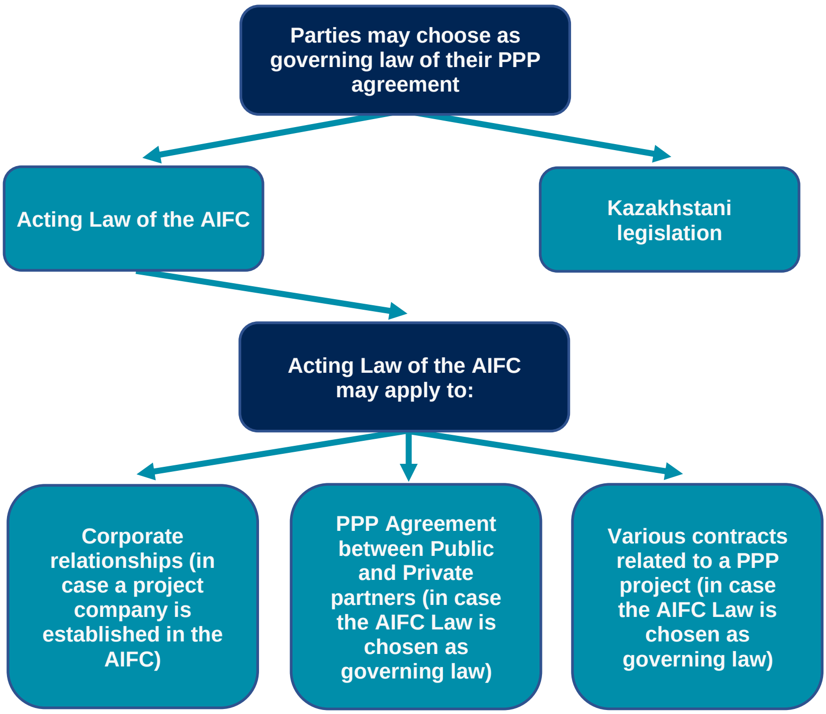
- Preferential tax regime (until 1 January 2066, AIFC Participants are exempt from corporate income tax and value-added tax on income received from providing certain financial services in the territory of the AIFC. Their employees are similarly exempt from individual income tax. In addition, AIFC Participants are exempt from corporate income tax on income received from legal, audit, accounting and consulting services provided to AIFC Bodies as well as to AIFC Participants that provide financial services);
- Simplified labour regime (AIFC Bodies and Participants are exempt from the obligation to obtain work permits in the Republic of Kazakhstan to employ foreign nationals);
- Simplified visa regime (Foreign employees and their dependent family members of the AIFC Bodies or AIFC Participants may obtain working visas for a period of up to 5 years. Visa issuance, extension, or change in a category can be processed at the AIFC Expat Centre without the need to leave the country).



WHY ACTING LAW OF THE AIFC?

It is well-known that English law is the preferred governing law for business transactions worldwide, even those that do not have any geographic connection with the United Kingdom. The AIFC is considered to be a unique place in the Commonwealth of Independent States since it is the first and only jurisdiction whose Acting Law is based on principles, legislation, and precedents of English common law. You will greatly enjoy the AIFC law if you would like to structure your contract based on common law.

The Acting Law of the AIFC may be chosen as governing law in your PPP agreement and other contracts (construction contract, operation contract, supply or service contract, etc.). It will also govern corporate relationships if you decide to incorporate a legal entity in the AIFC.

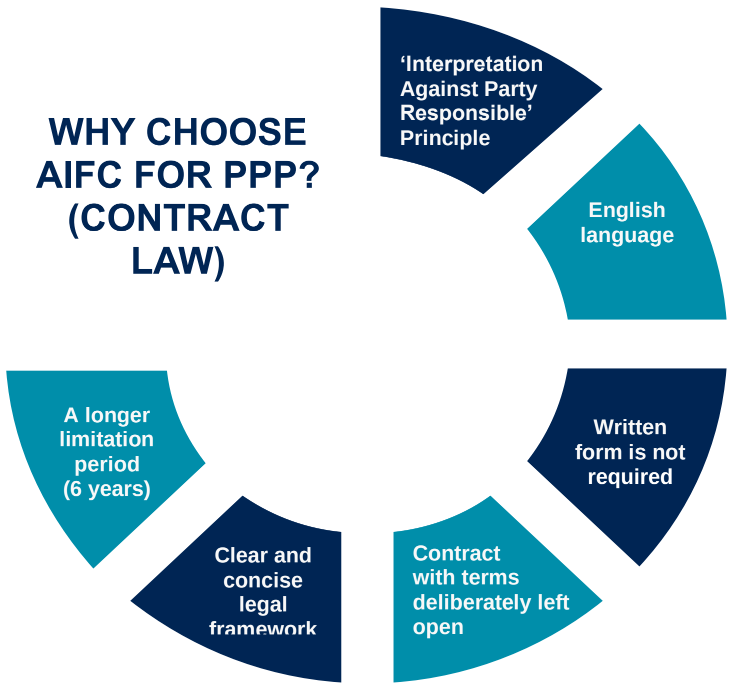


WHY CHOOSE AIFC FOR PPP? (CONTRACT LAW ASPECTS)

Overall, a common law system is less prescriptive than a civil law system, and the basic principle of AIFC contract law is an extensive freedom of contract when setting up a contractual relationship between two parties (Section 8 of the AIFC Contract Regulations 2017).

While parties have a general freedom to choose the terms, format, and content of their bargain, the following should be noted:

- Generally, contracts need not be in writing;
- Contracts can be written, created by conduct, implied from circumstances, arise by operation of AIFC acts, orally created or a combination of the preceding modes of creation;
- Contract operation and enforcement is generally facilitated by having a document signed by all parties evidencing the bargain;
- Generally, everything is permitted that is not expressly prohibited by law.



Some advantages of the Acting Law of the AIFC over legislation of countries with a civil law system are:

- The ‘interpretation against the draftsman’ doctrine (Section 54 of the AIFC Contract Regulations 2017). If a term, the wording of which was provided by your counterparty, in your PPP agreement is ambiguous, the preferred meaning should be the one that works against interests of your counterparty (i.e. the party who provided the wording).
- English language. The AIFC acts are drafted in the English language which eliminates the need to employ translators and gives you an opportunity to read and understand provisions of the AIFC acts on your own.
- Written form is not required (Section 9 of the AIFC Contract Regulations 2017). Your contract may be proved by any means, including witnesses.
- Contract with terms deliberately left open (Section 27 of the AIFC Contract Regulations 2017). You and your counterparty may agree to conclude a contract related to the PPP project and intentionally leave a term in it to be agreed upon in further negotiations or to be determined by a third person.
- Clear and concise legal framework. Not only do AIFC acts embody international best practice standards but they also include the main principles and provisions. For example, the AIFC Company Regulations 2017 consist of 205 sections and one schedule whereas the United Kingdom’s Companies Act 2006 contains 1,300 sections and contains 16 schedules.
- A longer limitation period (6 years) in comparison with other countries in this region (3 years). A longer limitation system provides fairness to both plaintiffs and defendants. It is also sufficiently flexible to cope fairly, not only with damage that is suffered immediately or shortly after occurrence of a wrongful act, but with latent damage in your PPP project that can only be detected years after the relevant event.

WHY CHOOSE AIFC FOR PPP? (CORPORATE LAW ASPECTS)

Incorporating a project company in the AIFC is a very straightforward process. Moreover, when you form a company (a PPP project company is usually set up in a form of a public company, private company, special purpose company, or limited liability partnership), you are given to certain benefits as well as a strong and reputable legal system.

Setting up a company for a PPP project may be attractive for several reasons. For instance, your company will have a separate legal identity from the owners. In addition, the Acting Law of the AIFC provides you with a certain level of flexibility in governing corporate matters.

Detailed advantages for each of the above-mentioned business vehicle are described below.

Private Company

- ✓ **Separate legal personality.**
- ✓ **Governing rules can be largely self-determined.**
- ✓ **Can be formed with a single member but has no statutory limit on the number of shareholders.**
- ✓ **The liability of its shareholders to contribute to the assets of the company is limited to the amount, if any, unpaid on the shares held by them.**
- ✓ **Incorporation can be undertaken quickly in one day at low cost.**
- ✓ **Only one director is required and company secretaries are optional.**
- ✓ **Shareholders are able to pass resolutions by way of written resolution or at a general meeting.**
- ✓ **It is possible to re-register as a public company, subject to satisfaction of certain requirements.**
- ✓ **There is no minimum issued share capital and reductions of capital can be undertaken using a statutory procedure rather than with court approval.**
- ✓ **Any purchase or redemption of its own shares can be funded out of capital.**

Public Company

- ✓ **Separate legal personality.**
- ✓ **Ability to offer its securities to the public.**
- ✓ **Minimum share capital is only U.S. $100,000.**

Limited Liability Partnership

- ✓ Separate legal personality.
- ✓ Liability of members can be limited to the amount of their capital investment in the LLP.
- ✓ No statutory upper limit on the number of members (although there must be a minimum of two members).
- ✓ Partners can be of any nationality.
- ✓ No capital maintenance requirements.

Special Purpose Company

- ✓ Separate legal entity with limited liability.
- ✓ There is no minimum share capital requirement for a SPC, which can be structured in both conventional and Sharia compliant forms.
- ✓ No need to rent office space - SPCs do not have to lease office space in the AIFC.
- ✓ Reduced accounting requirements – there is no need for SPCs to produce accounts and additionally there is no requirement accounts to be audited or filed with the AIFC's Registrar of Companies.
- ✓ No annual general meeting requirement.
- ✓ Can help firms secure projects from commercial financial or operational failures of the entity (i.e. isolates risk from the parent company by maintaining its assets and liabilities on a completely separate balance sheet).
- ✓ Can be used to finance new projects (including infrastructure projects) without increasing costs or altering the shareholding.
- ✓ A Director of a Special Purpose Company who is an individual is not required to reside in Kazakhstan.

LIFE CYCLE OF THE PPP PROJECT

Kazakhstani law

1. Development of the investment proposal by a public partner/business plan to the PPP project by a private partner (private initiative)

Kazakhstani law

2. Determination of the private partner

Acting Law of the AIFC*

3. Signing a PPP agreement

Acting Law of the AIFC*

4. Implementation of the PPP project/ monitoring of the project

Acting Law of the AIFC*

5. Completion of the PPP project

***AIFC Acts that may apply to a PPP project** *(the list is not exhaustive and may vary on a case-by-case basis):*

Companies Regulations & Rules	**Special Purpose Company Rules**	**Contracts regulations**
General Partnership Regulations & Rules	**Limited Partnership Regulations & Rules**	**Limited Liability Partnership Regulations & Rules**
Implied Terms in Contracts and Unfair Terms Regulations	**Regulations on Damages and Regulations**	**Regulations on Obligations**
Employment Regulations	**Data Protection Regulations & Rules**	**Security Regulations & Rules**
Insolvency Regulations & Rules	**Preferential Creditor Rules**	**Netting Regulations**
Islamic Finance Rules	**Joint Orders with public authorities (tax administration, Expat Centre)**	**AIFC Court Regulations & Rules**
AIFC Arbitration Regulations & IAC Arbitration and Mediation Rules	**AIX Business Rules**	**AIX Group Code of Conduct**

Acting Law of the AIFC can be chosen as governing law of your PPP agreement or some other contracts (e.g., between a contractor and sub-contractors) in the following cases (Section 7 of the AIFC Contract Regulations 2017):

1) If a contract is made between AIFC Participants, AIFC Bodies and AIFC Participants, and AIFC Bodies, unless otherwise expressly provided in a contract;

2) expressly provided in a contract (where one of the parties to a contract is an AIFC Participants or AIFC Body);

3) expressly provided in a contract (where none of the parties to a contract is an AIFC Participants or AIFC Body).

Although the Acting Law of the AIFC starts applying to your PPP agreement or other PPP contracts only after they are signed, you are recommended to contact the AIFC representatives (please refer to the ‘Contact Us” section) or advisors/consultants early on. Ideally, you should contact them as soon as you decide to prepare a bid for a PPP project or private finance initiative.

UNDERSTANDING PPPS

A PPP is a long-term contract between the public and private sectors to deliver public infrastructure projects and related services. Typically, PPPs lend themselves well to:

- Social infrastructure and related services (e.g., a hospital, prison, school, or court); and
- Economic infrastructure and related services (e.g., those that relate to energy, water, telecommunications, and transport).

PPPs characteristically include:

- Private partner taking on design, construct, and operation risks to drive innovation and productivity improvements;
- Public partner providing land, risk sharing, and other mechanisms; and
- Private partner receiving payment from Government or taking on demand risk for service provision.

In order to determine whether a PPP is an appropriate delivery model for your infrastructure project, it is important to understand the project's key drivers and constraints including consideration of budget, timeframes, stakeholder commitments, and market capacity. Another important aspect that you need to consider is risk sharing and performing tasks that best fit their area of competence.

The list below includes some of the risks that you and your counterparty should negotiate individually for each PPP contract:

- Revenue risk;
- Construction risk;
- Foreign exchange risk;
- Regulatory/contractual risk;
- Political risk;
- Environmental/archaeological risk;
- Latent defect risk;
- Public acceptance risk;
- Sustainability risk.

SELECTION OF THE MOST SUITABLE PPP TYPE

One should note that PPP arrangements should not be entered into merely for the sake of undertaking a PPP project. A comprehensive review of the costs and benefits of private sector involvement versus public alternatives must be undertaken to ensure that a PPP enhances the public benefit.

As you will see further, there is no ‘best’ model of PPP structure as the PPP process is extremely dynamic in nature. When parties consider selecting a certain type of PPP, due regard should be given to appropriateness, cost, and the ability to effectively implement and manage the project.

You are recommended to select the most suitable PPP type depending on the degree of your and your counterparty’s involvement in designing, construction, maintenance, finances, operation, management, and allocation of risks in public services provision and/or construction of public infrastructure.

The list below is by no means exhaustive and includes different PPP models.

1) **Build-Lease-Operate-Transfer (BLOT).** Under this PPP type, the private partner builds and leases a facility, while its ownership remains with the public partner. The private partner provides services and upon expiration of the agreement, the ownership of the facility is returned to the public partner.

2) **Build-Operate-Transfer (BOT).** In this model, the private partner builds and finances the construction of the public facility and uses it to provide service under control of the public entity. The private partner uses the facility under the long-term lease/concession and upon the expiration of the lease, the facility is transferred back to the public partner.

3) **Build-Own-Operate (BOO).** In the BOO model, the private partner builds and manages the public property in their ownership without obligation to transfer the assets to the public partner. Thus, the private partner assumes equity and other commercial risks as well as

construction risks. The public partner regulates and controls services provided by the private partner. This model may be a good solution for toll roads.

4) **Build-Own-Operate-Transfer (BOOT).** In the BOOT model, a government entity grants to a private sector party the right to finance, design, construct, own, and operate a project for a certain period of time. This model is often used to build power stations, water treatment facilities, and sewage facilities.

5) **Buy-Build-Operate (BBO).** Under this PPP type, the private partner buys the public facility under the contract that the assets are to be upgraded and operated for a specified period of time. The private partner also provides services to the public partner and/or end users. By expiration of the term, the private partner retains ownership over the public asset.

6) **Buy-Own-Operate-Transfer (BUYOOT).** Under this model, the private partner buys public facility, uses it for a specified period of time and provides the service. Upon expiration of the agreement, the facility is transferred to the public partner without charge.

7) **Design-Bid-Build (DBB).** In the DBB model, the public partner defines the requirements for the project, ensures its financing and design. The procurement procedure is used to select a private bidder, responsible for the construction. The public partner is the owner of a newly constructed facility and provides its service and maintenance.

8) **Design-Build-Finance (DBF).** Under the DBF type, the private partner is acting not only as construction contractor but also as a lender to the public sector. The lending is indirect, as ultimately the funds will be provided by a lending institution – such as a bank – against a pledge on the right to receive the government payments. The payments are not made until the end of the construction period.

9) **Design-Build-Finance-Maintain (DBFM).** In the DBFM model, the private partner is not only fully responsible for designing and building the facility, but also handles the administration and maintenance. In comparison with the traditional contracts where the government buys a product (e.g., a road), in a DBFM contract, the government buys a service: the provision of an available road.

10) **Design-Build-Finance-Operate (DBFO).** In the DBFO model, the private partner designs, builds, and finances a new public facility under a long-term lease. During the lease period, the private partner operates the facility and upon expiration, the facility is transferred to the public partner.

11) **Design-Build-Finance-Operate-Maintain (DBFOM).** Under the DBFOM model, the private partner will develop the infrastructure with its own funds and/or funds raised from lenders at its risk. It will also be responsible for managing the infrastructure life cycle in addition to current maintenance and operations.

12) **Design-Build-Finance-Own-Operate-Transfer (DBFOOT).** In this model, the private partner designs, develops, builds, and finances the implementation of a project. The private partner provides the services and uses the facility, which is its property, for a specified period of time. By expiration of that period, the ownership is transferred to the public partner without compensation.

13) **Design-Build-Maintain (DBM).** In this model, the private partner designs, builds, and maintains the infrastructure in accordance to the specifications and requirements of the public partner.

14) The price is usually pre-agreed and fixed, so the risk and cost of quality assurance and maintenance of the constructed facility is on the private partner. The public entity owns and operates the assets.

15) **Design-Build-Operate (DBO).** In the DBO model, the private partner designs and builds a public property according to the requirements and specifications of the public partner and at a fixed price. The public entity bears financing and costs. Once the construction is completed, the private partner takes the property in a long-term lease to provide service.

16) **Finance Only (FO).** Under the FO model, a private entity, such as a financial services company, a pension fund, or a bank, funds the construction of the public infrastructure directly or through mechanisms such as a long-term lease or a bond issue. The public partner bears all risks and costs of the construction and operation of the facility.

17) **Lease-Develop-Operate (LDO).** In case of the Lease-Develop-Operate model, the private partner leases the public facility, develops and improves it technologically and functionally, as well as

operates it. The public partner retains ownership of the newly created infrastructure facility and receives payments according to the lease agreement. This PPP type is mostly used in the development of airport facilities.

18) **Operation License (OL).** In the Operation License model, the private partner receives a licence or rights to build and operate a public service, usually with limited duration. This model is frequently used in telecommunications and information and communications technology projects.

19) **Operate-Maintain (OM).** Under this model, Management and operation of a public infrastructure is outsourced to a private company. This model may be suitable for projects with a significant operating content.

20) **Rehabilitate-Own-Operate-Transfer (ROOT).** Under this model, an existing facility is turned over to the private partner to refurbish, operate, and maintain for a franchise period, at the expiry of which the legal title to the existing facility is returned to the public partner. This PPP type is suitable for capacity expansion or road upgrading.

21) **Rehabilitate-Own-Operate (ROO).** In this model, an existing facility is turned over to the private partner to refurbish and operate with no time limitation. As long as the operator is not in violation of its franchise, it can continue to own and operate the facility.

The next pages provide you with the information on how the BOOT, DBFM, DBFOM, and FO models can be structured in the AIFC Jurisdiction and how you can enjoy certain benefits that the AIFC offers depending on the PPP type that you selected. Please note that the described models are not exhaustive and serve only as a guide.

ESTABLISHMENT OF SPECIAL PURPOSE COMPANY (SPC) BY PROJECT COMPANY

The creation of a Special Purpose Company (SPC) is a key feature of most PPPs. The SPC is a legal entity that undertakes a project and separates the risks and balance sheet from the core business of the Project company. All contractual agreements between the various parties are negotiated between themselves and the SPC. SPCs are also a preferred mode of PPP project implementation in limited or non-recourse situations, where the lenders rely on the project's cash flow and security over its assets as the only means to repay debts.

The Project Company should analyse if the PPP project require to be established through a separate legal entity such as SPC. The SPC for large capital-intensive projects can help isolating the project promoters from claims in case of bankruptcy (their risk can be limited to their equity investments in the SPC). On the other hand, creditworthiness of the SPC will depend almost solely on the cash flow generated by the project while it allows to provide investors with a separate structure (SPC) for investment purposes.

Establishment of SPC in Kazakhstan have following competitive advantages in comparison to other jurisdictions:

No	SPC Features	AIFC	DIFC	ADGM	Netherlands	Ireland
1	Legal Form	SPC	Ltd, SPC	Ltd, RSC	BV (Ltd)	Ltd, DAC, Section 110
2	Timing of Establishment, business days	5	5	5	5	5
3	Minimum share capital	**USD 0**	**USD 100**	USD 0	USD 0	EUR 1
4	Substance Requirement (Physical Office Space)	No	No	No	No	No
5	Locally Registered Office Address Requirement	Yes	Yes	Yes	Yes	Yes
6	Shelf Company offer is permitted	**Yes**	**No**	Yes	Yes	Yes
7	Corporate body Directors are permitted	**Yes**	**No**	Yes	Yes	Yes

8	Restrictions on the number of Directors	**≥ 1**	**≥ 2**	≥ 1	≥ 1	≤ 25
9	Restrictions on the number of Shareholders	**≥ 1**	**≤ 3**	≥ 1	≥ 1	≥ 1
10	Incorporation by Corporate Service Provider is permitted	**Yes**	**Yes**	Yes	Yes	Yes
11	Majority of the Directors to be employees of its Service Provider	**No**	**Yes**	No	No	No
12	Secretary must be a CSP or a subsidiary of CSP	**No**	**Yes**	No	No	No
13	Requirement for shareholders to be based in the Centre	**No**	**No**	No	No	No
14	Access to Double Tax Treaty network, number of active treaties	**53**	**70+**	70+	99	72

The applications forms can be found at https://afsa.aifc.kz/special-purpose-company/.

Person applying for the incorporation of a SPC must be an Incorporator, a Corporate Service Provider or any law or accounting firm. SPC must receive its corporate administration services from a Corporate Service Provider. SPC may receive administration services for its assets from a third-party asset administration or management provider.

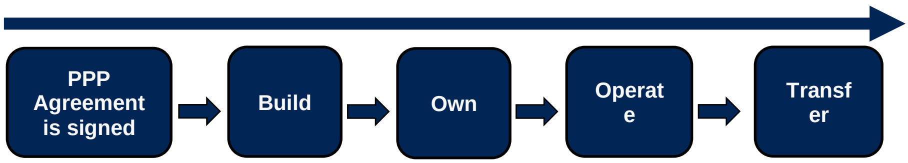
Registration Support Department of AIFC Business Connect Ltd. is at hand to support and guide organisations through the whole registration process for SPC and all potential participants. Deal Sourcing Department of AIFC Business Connect Ltd. will help to match the investor with an advantageous project or find the best source of financing to the project. Business Development Department of AIFC Business Connect Ltd. may study the PPP projects and develop products and services offerings within AIFC to tailor your PPP project needs.

All contacts are provided at the end of the document.

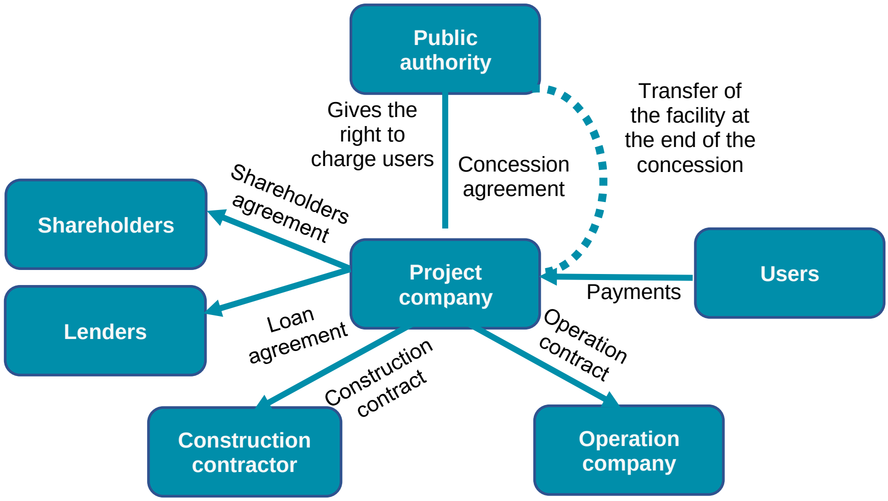
HOW YOU CAN USE THE AIFC JURISDICTION (BOOT MODEL)

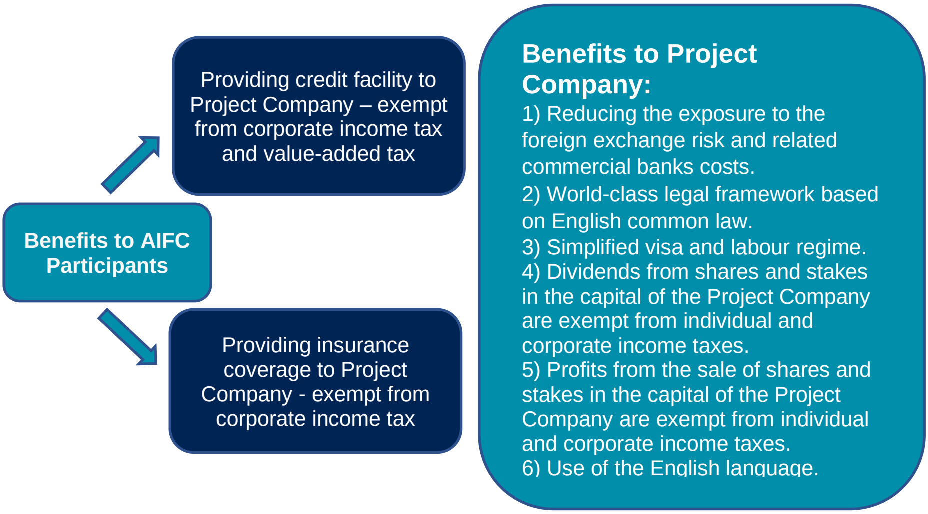
HOW TO EFFECTIVELY USE THE AIFC JURISDICTION?

Basic Scheme of a BOOT Contract Structure



Typical BOOT model





Under the BOOT model, a Project company (or established SPC) incorporated in the AIFC to implement a PPP project can enjoy a world-class legal framework based on English common law, simplified visa and labour regime as well as currency regulation (articles 5, 7, and 8 of the Constitutional Statute). Shareholders (both natural and legal persons) of the Project company are exempt from individual and corporate income tax on income received from profits from the sale of shares or stakes as well as dividends from shares or stakes in the capital of the Project company (Article 6 of the Constitutional Statute).

A Project company may choose the Acting Law of the AIFC as governing law not only in the PPP agreement but also in contracts with its contractors. For example, the AIFC Law can successfully be chosen with construction contractors as governing law in FIDIC contracts, which are based on English law principles (e.g., provisions relating to liquidated damages have been maintained). At the same time, the monetary obligations of AIFC Participants may be denominated and executed in the currencies agreed in their contracts (Article 5 of the Constitutional Statute).

In the event of any dispute or disagreement, parties may refer their case to the AIFC Court. Justices of the AIFC Court are eligible to take into account final judgements of other courts including the courts of

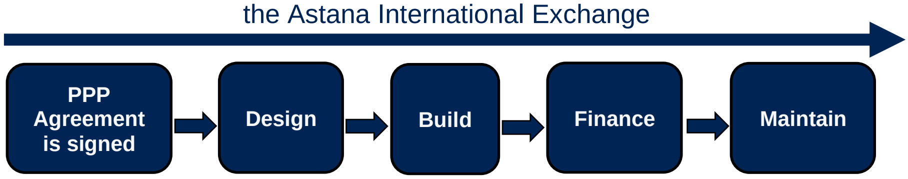
Australia and Canada (Article 13 of the Constitutional Statute) that are considered to be leading jurisdictions in terms of PPPs.

AIFC Participants are exempt from corporate income tax and value-added tax on income received from effecting and carrying on contracts of insurance (e.g., plant and equipment insurance, third-party liability insurance, worker's compensation insurance, insurance for business interruption, and interruption in cash flows and cost overrun) and providing credit to the Project company.

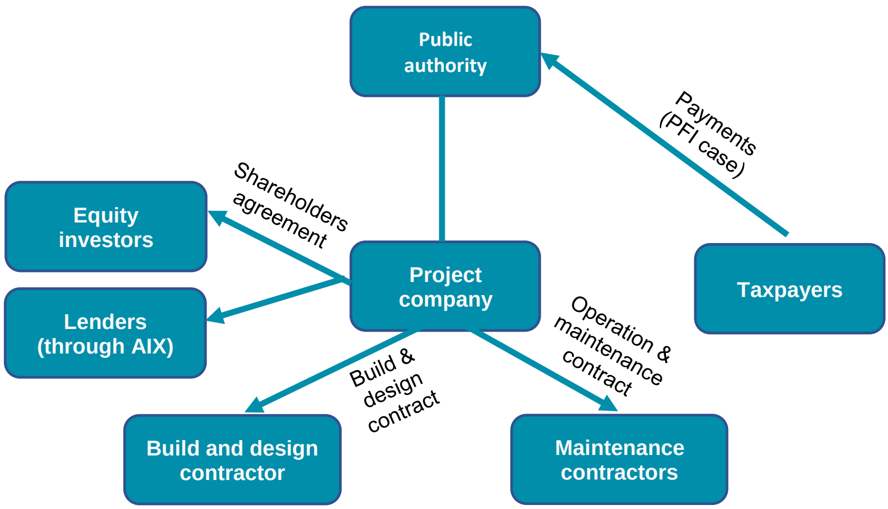
HOW YOU CAN USE THE AIFC JURISDICTION (DBFM MODEL)

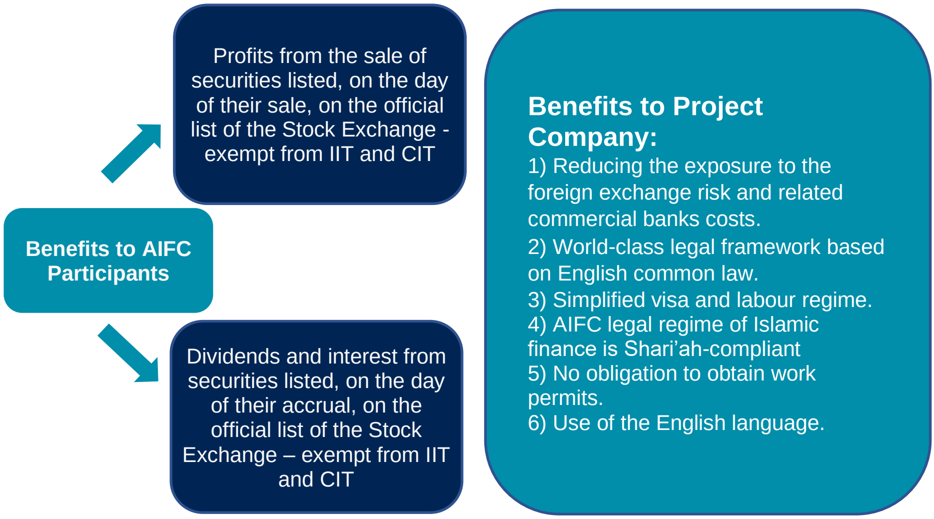
HOW TO EFFECTIVELY USE THE AIFC JURISDICTION?

Basic Scheme of a DBFM Contract Structure attracting finance through the Astana International Exchange



Typical DBFM model





If a PPP project is structured through the AIFC in the DBFM model, a Project company incorporated in the AIFC can also enjoy the same benefits as in the BOOT model. Shareholders (both natural and legal persons) of the Project company are exempt from individual and corporate income tax on income received from profits from the sale of shares or stakes as well as dividends from shares or stakes in the capital of the Project company (Article 6 of the Constitutional Statute). In addition, if a Project company decides to raise funding through the AIX, natural and legal persons are exempt from individual and corporate income tax on income received from:

1) profits from the sale of securities listed, on the day of their sale, on the official list of the AIX; and

2) dividends and interest from securities listed, on the day of their accrual, on the official list of the AIX (Article 6 of the Constitutional Statute).

Also, a Project company may choose the Acting Law of the AIFC as governing law in their contracts which may offer to parties greater flexibility and instruments unavailable in some countries with a civil law system.

Choosing the AIFC Court or International Arbitration Centre (IAC) as the place for resolving disputes guarantees parties to a contract that their possible disagreement will be resolved by a highly experienced and skilled British judge or arbitrator. At the same time, parties may firstly refer to mediation, and a mediator will help parties find an amicable and 'win-win' solution. Currently, all applications, administration, and hearings at the AIFC Court and IAC **are free of charge until 31 December 2021**. Moreover, if parties to a contract which is agreed before 31 December 2021 and includes the AIFC Court or IAC for dispute resolution will be eligible to receive free administration of any dispute resolution at the AIFC Court or IAC under that contract before and after 31 December 2021.

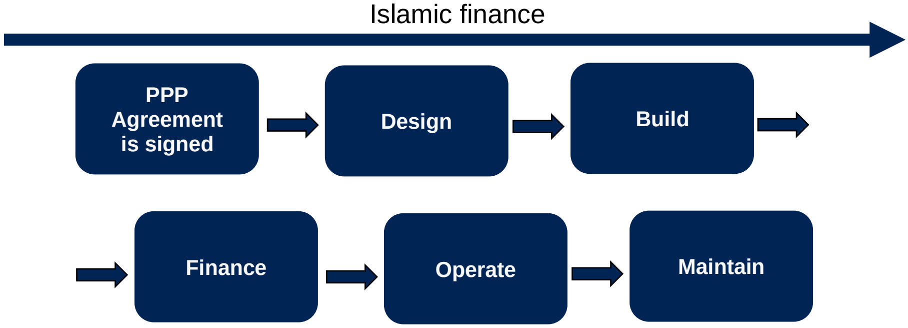
It is worthy to note that cases can be filed at the AIFC Court and IAC online via the eJustice system which can be accessed via the AIFC Court and IAC websites. It means that any dispute can be resolved using audio and video technology, by written submissions and email.

AIFC Participants can also benefit as they are exempt from corporate income tax and value-added tax on income received from effecting and carrying on contracts of insurance with the Project company.

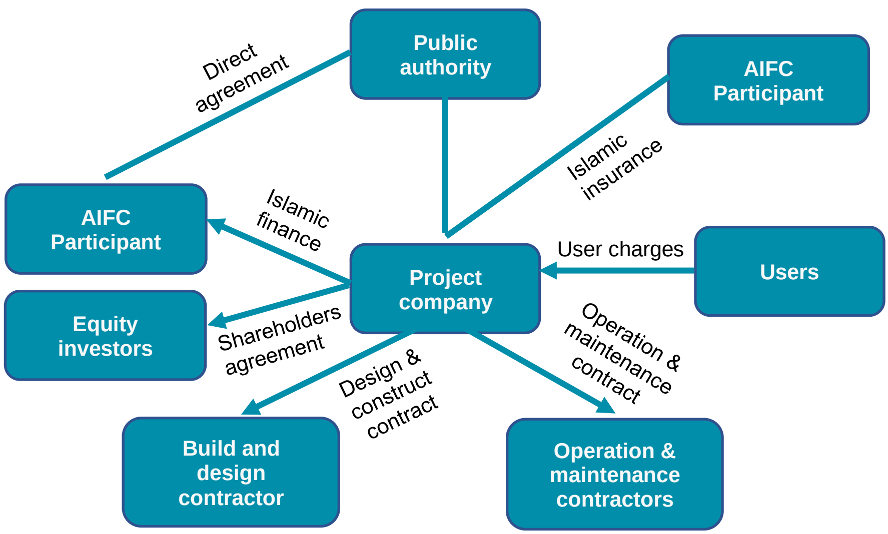
HOW YOU CAN USE THE AIFC JURISDICTION (DBFOM MODEL)

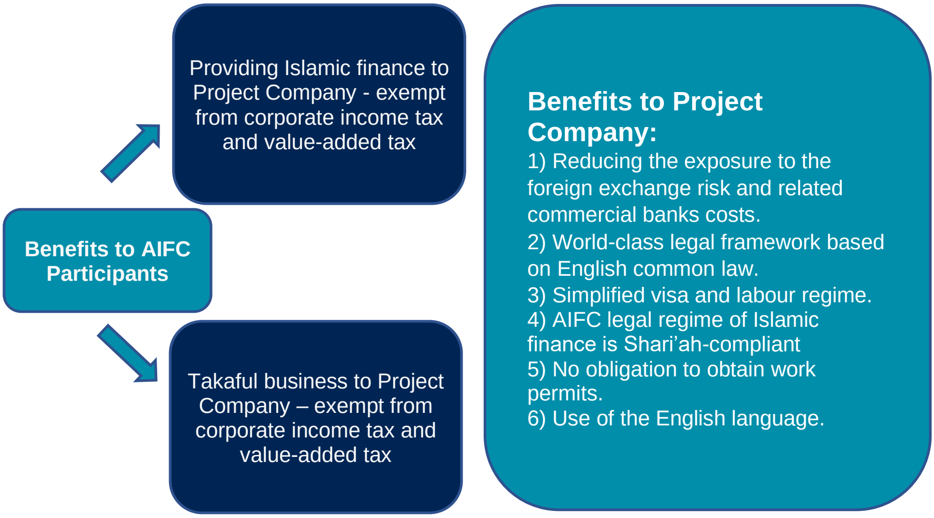
HOW TO EFFECTIVELY USE THE AIFC JURISDICTION?

Basic Scheme of a DBFOM Contract Structure (user-pays) using Islamic finance



Typical DBFOM model





Structuring a PPP project under the DBFOM model using Islamic finance in the AIFC allows some parties engaged in the project to have certain tax exemptions. For example, AIFC Participants are exempt from corporate income tax and value-added tax if they are involved in providing Islamic finance or in Takaful business. To ensure their activities are Shari'ah-compliant and meet the relevant requirements, they can refer to the Islamic Finance Rules and Islamic Banking Business Prudential Rules.

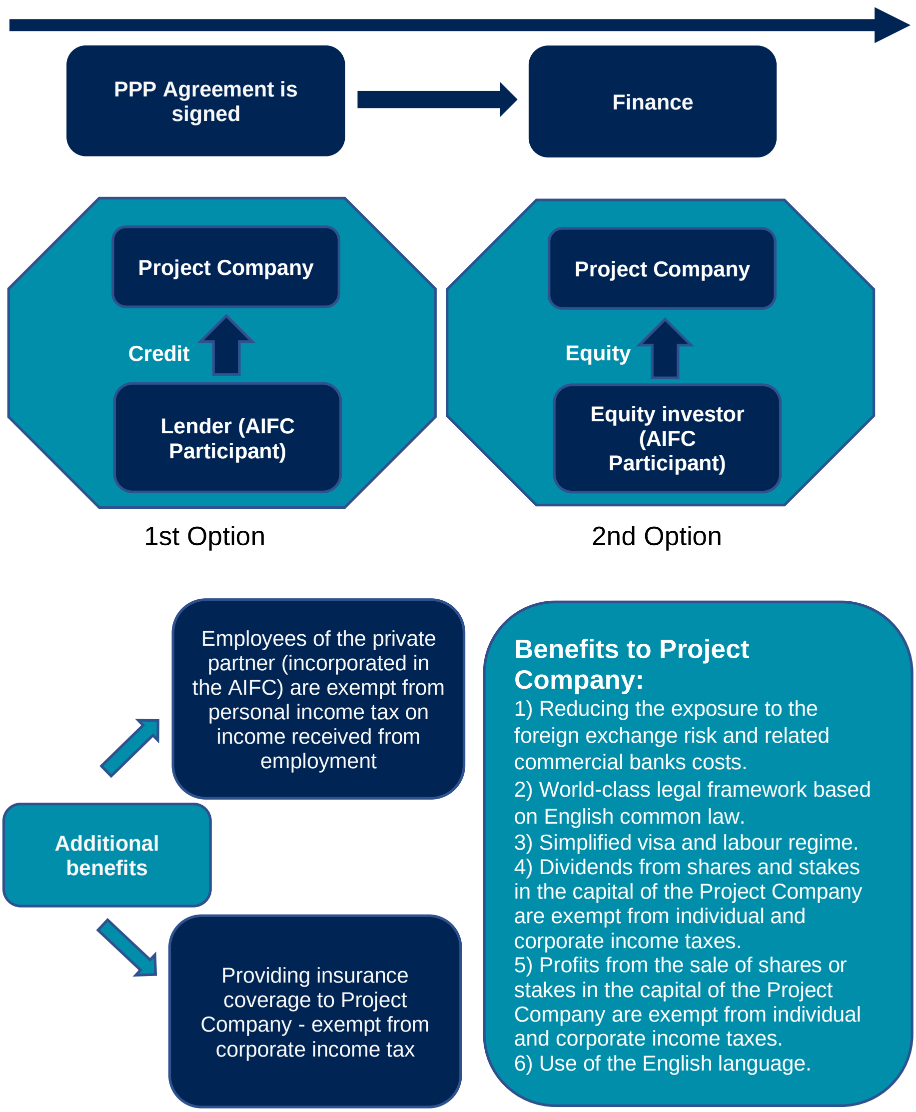
A Project company incorporated in the AIFC and its shareholders will have the same benefits as described in the BOOT and DBFM models. As the operation and maintenance services should be provided under the DBFOM model, the Project company may conclude with its contractors' performance-based contracts. Performance based contracts are considered result-oriented contracts that focus on the outputs, quality, or outcomes that may tie at least a portion of a contractor's payment, contract extensions, or contracts renewals to the achievement of specific, measurable performance standards and requirements.

This document provides you with more information on how Islamic finance can be applied in infrastructure projects through PPP schemes and describes several standard Islamic finance instruments (please see below).

HOW YOU CAN USE THE AIFC JURISDICTION (FO MODEL)

HOW TO EFFECTIVELY USE THE AIFC JURISDICTION?

Basic Scheme of a Finance Only model



If you a representative of the pension fund, insurance company, or sovereign wealth fund (an institutional investor), you may consider your participation in the PPP project through the Finance only model. In this case, you may incorporate a legal entity in the AIFC that can provide funding to the implementation of not only a PPP project but also other projects. This gives you a privilege to be exempt from corporate income tax and value-added tax on income received from providing credit. There are actually many other ways in which institutional investors can be engaged and enjoy the benefits which the AIFC offers.

Investing in the Project company through the AIX is another option where you can participate in the project and enjoy a preferential tax regime. As in the example above, an institutional investor may invest in many other projects and companies in the AIFC, including small and medium-sized enterprises (e.g., through crowdfunding platforms).

In both instances, foreign nationals who are employees of the AIFC Participant will be exempt until 1 January 2066 from personal income tax on income received from activities in the AIFC under their employment contracts.

A Project company incorporated in the AIFC will have the same benefits as described in the BOOT, DBFM, and DBFOM models above.

FINANCING OPTIONS FOR PPP PROJECTS WITHIN AIFC

Usually, big infrastructure projects require large investments; therefore, most infrastructure PPP projects face the need to involve two or more financial institutions to provide syndicated/pooled financing. The AIFC ecosystem includes a set of financing instruments to attract financing for PPP projects through the AIX.

PRIVATE PLACEMENTS

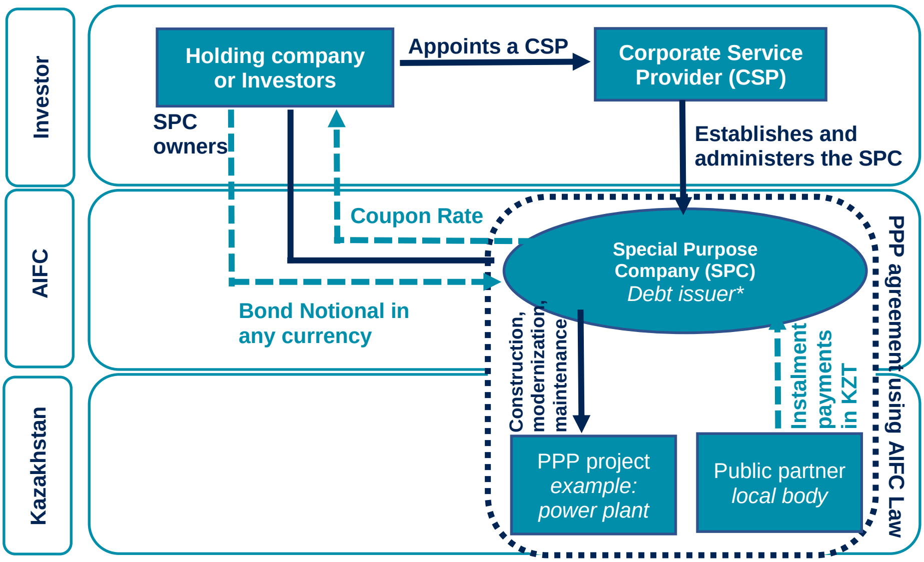
Private placement of bonds is a sale of bonds to pre-selected investors and institutions rather than on the open market. This instrument allows to obtain financing at an attractive rate which may be lower than a loan from commercial banks and, accordingly, is more profitable for the issuer. Both AIFC residents and non-residents can attract funding through private placement on AIX where bonds can be issued in any currency by request (US Dollar, Euro, Ruble, Kazakh Tenge, RMB etc.).

This instrument can also be used through the described Special Purpose Company (SPC) established by the Project company (holding company) within AIFC for PPP project implementation. In this case, the SPC issues bonds while the holding company purchases them acting as a pre-selected investor. The SPC can pay the coupon rate from the payments provided by the public partner within PPP contract. All coupon payments are tax exempt, tax exemption applies to the instruments themselves meaning that Kazakhstani residents do not pay income tax (for non-residents other jurisdictions' taxes may apply).

In case a holding company decides to sell an SPC, capital gain from the sale of SPC is tax exempt (no personal income tax and corporate income tax in accordance with the Constitutional Statute).

Financing – Private placement by SPC through AIX

PPP project financing could be done through the issue of a public or private placement (private bonds)



***Initial listing fee on AIX for the year 2020 is $20,000, annual fee is $20,000-$50,000 depending on the issue size.**

All coupon payments, capital payments are tax exempt. Tax exemption applies to the instruments itself meaning that KZ residents do not pay income tax (for non-residents other jurisdictions' taxes may apply)

Capital gain from the sale of SPC are tax exempt (no personal and corporate income taxes in accordance with the Constitutional Statute)

Kazakhstan Investment Development Fund

Co-investment by Kazakhstan Investment Development Fund (KIDF). KIDF is registered in the jurisdiction of the AIFC and created by the Government of the Republic of Kazakhstan in order to attract foreign direct investment in the non-resource sector of the country, namely in the manufacturing industry, the agro-industrial complex, the innovation sector and in the development of infrastructure (energy, transport, logistics, tourism) through co-investment in large projects with foreign investors. The co-investment principle attracts investors through risk redistribution. The risks are also reduced due to the lower entry threshold making investing in PPP projects more attractive.

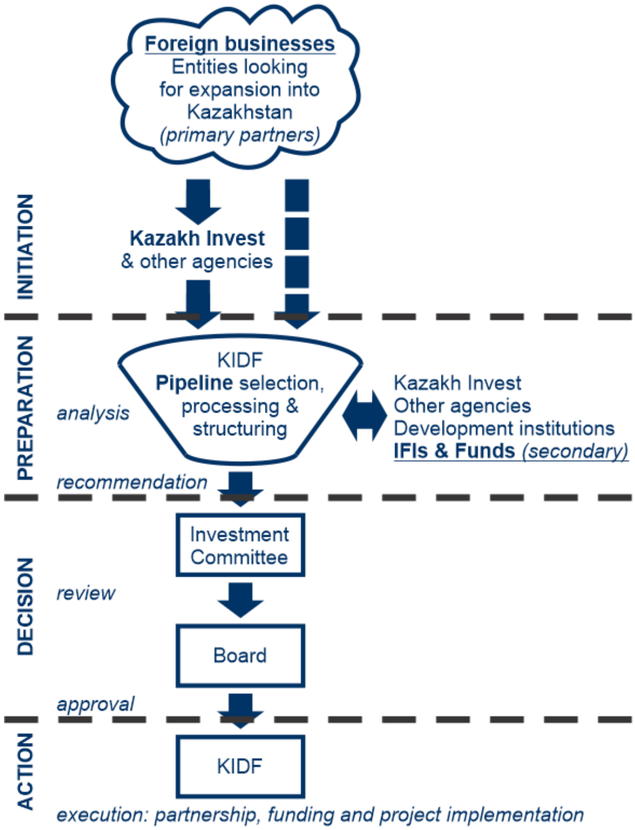
KIDF is one of the vehicles of the state infrastructure aimed to improve attractiveness of investment climate in the country. Within that ecosystem the state provides foreign investors with a combination of the following support:

- ✓ secure legal framework via Common Law on AIFC;
- ✓ in-kind contributions like land rights, infrastructure, and access to resources through regional government's offices;
- ✓ tax preferences (value-added tax, corporate income, land, and property tax exemptions) through state agencies;
- ✓ reasonably priced debt in local and foreign currency (match currency exposure of an asset being created/developed) through the development institutions; and
- ✓ in the end, sharing equity investment risks with cash equity co-funding through KIDF.

KIDF source the project pipeline primarily via Kazakh Invest (a state investment promotion agency). Kazakh Invest scouts around the world for entrepreneurs and businesses with a recognizable product/service brand, good corporate governance, effective business processes and practices, positive track record, and capability for growth in the region.

When a potential investor indicates an interest in expanding its business into Kazakhstan, a whole set of state agencies and institutions elaborate on feasibility of a prospective development and applicable government support measures necessary to improve economic performance for an investor, if needed.

KIDF takes part in a foreign investor's initiatives in Kazakhstan in case that investor sees a benefit in sharing equity risk with the state. KIDF joins a prospective transaction near financial closure stage.


Foreign businesses
Entities looking for expansion into Kazakhstan
(primary partners)
INITIATION
Kazakh Invest
& other agencies
PREPARATION
analysis
KIDF
Pipeline selection, processing & structuring
Kazakh Invest
Other agencies
Development institutions
IFIs & Funds (secondary)
recommendation
DECISION
Investment Committee
review
Board
approval
ACTION
KIDF
execution: partnership, funding and project implementation

GREEN FINANCING

The AIFC Green Finance Centre is an AIFC Organisation created to enable the development of green finance in Kazakhstan and Central Asia. The main goal is to bring investments to sustainable economy through trending financial instruments, such as green and social bonds. In addition to that, the AIFC Green Finance Centre, being a regional think-tank, provides strategic and business consulting in green finance and sustainable development to Governments, quasi-state organisations and entrepreneurs.

The Centre provides initial assistance to potential issuers, investors, and market players on preparations for the issuance of green bonds on AIX.

Green finance refers to investments and other financial instruments aimed at delivering environmentally friendly, energy efficient, and low carbon projects. Green bonds, concessional lending, subsidies for green projects, etc. are the main green finance instruments. These financial instruments allow green projects to develop, which would be impossible under standard financial conditions.

Green finance instruments are a component of the capital market that come as an extension of the range of financial instruments and, therefore, opportunities offered to investors, mostly international, given that the green agenda is well developed in Western Europe, North America, and is gaining momentum in Southeast Asia.

Issuers

- National Issuers
- Sovereign Issuers
- Corporate Issuers

AIFC Green Finance Centre

- ✓ Internal company documents and policies preparation
- ✓ Independent conclusions preparation
- ✓ Financial and legal consultancy
- ✓ AIX listing implementation
- ✓ Post-reporting and checks following one-year green bond launch

ISLAMIC FINANCING

As the AIFC is the first platform in the region to provide businesses with systemic access to Islamic finance, a rapidly growing and promising segment, you may consider applying Islamic finance in infrastructure projects through PPP schemes.

The table below demonstrates that Islamic finance can successfully be applied in infrastructure projects as it perfectly fits into the PPP concept.

Principles of Islamic finance	Infrastructure PPP project
Returns should be linked to the profits/earnings and derived from commercial risk taken by financier	Infrastructure PPP projects allow risk to be shared among the parties involved in the project, including financiers
Islamic financiers become partners in the project	PPP projects allow Islamic financiers to become a party to the project, not just a mere lender
Transactions should be free from speculation or gambling (maysir)	Infrastructure PPP projects are by nature free from speculation or gambling
Existence of uncertainty in a contract is prohibited	Project contracts are generally well defined with no uncertainty (such as lump sum, turn-key, EPC contracts)
Investments relating to alcohol, drugs, gambling, weapons, and other prohibited activities are not permitted	Infrastructure PPP projects generally exclude these areas

Over the years, Islamic financing practices and their use in financing infrastructure PPP projects (e.g., roads, power generation, airports, seaports, and hospitals) have evolved and matured. You also need to take into account that both conventional finance and Islamic finance can coexist seamlessly and be applied in the same infrastructure PPP projects (the so-called ‘parallel financing’).

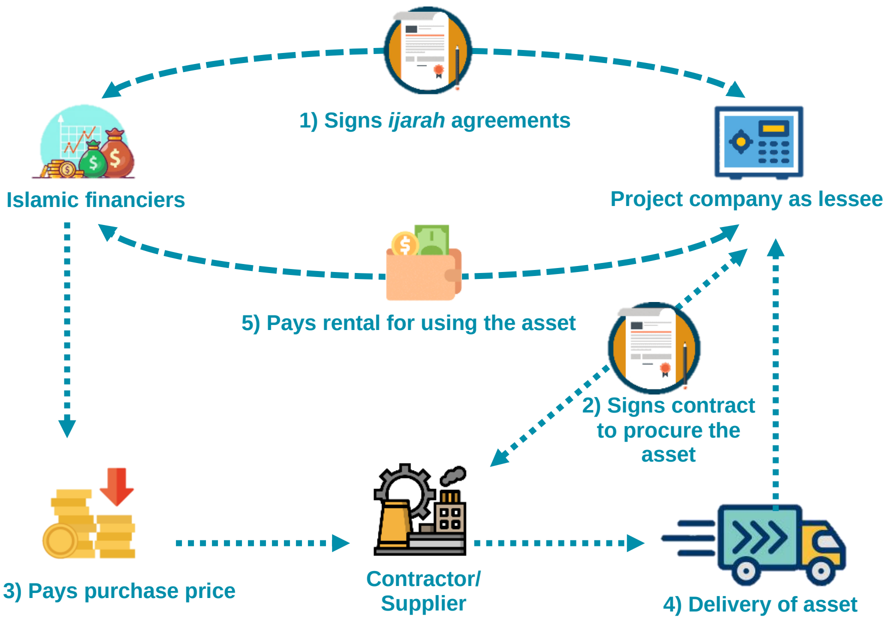
To meet the financing needs of infrastructure PPP projects, different Islamic finance instruments can be used both in isolation and in combination with other instruments to tailor bespoke financing solutions for PPP projects.

The following pages aim to introduce project finance techniques and basic Islamic finance instruments that are often used in infrastructure. As you will see further, different structures available for Islamic financing may provide significant flexibility to choose the most appropriate financing vehicle to fit the nature of the project.

IJARAH IN PPP PROJECTS

Ijarah, a lease, contract is used when the owner of an asset transfers ownership of usufruct (a right to enjoy the use and advantages of the property, as long as it is not wasted or destroyed) of the asset to another person in exchange for periodic payments. This widely used Islamic mode of finance can be suitable for financing fixed assets and capital equipment such as machinery and equipment for projects. Typically, ijarah entails the lease agreement, agency agreement, and service agency agreement.

Ijarah Structure and Related Steps



Under Shari'ah principles, the lessor would not necessarily hold the title of the ijarah, which means that the lessor can lease its usufruct to the Project company. Therefore, using ijarah financing can be beneficial in projects where the government wants to retain title to the project's assets, which is mainly because of the public nature of the assets.

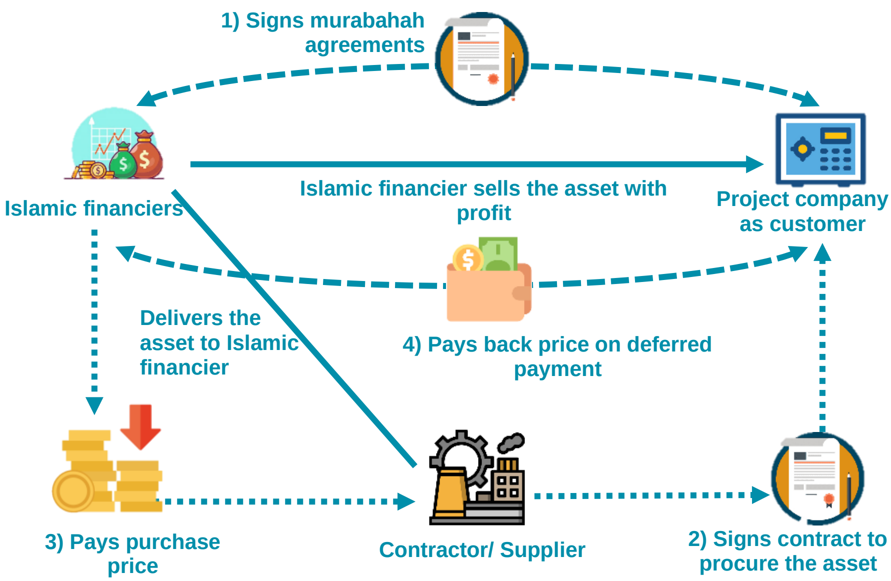
In infrastructure PPP projects, the Project company generally assumes the role of lessee. Thus, the Project company enters into a lease agreement with an Islamic financing institution so that it can make use of any particular component for the project, in exchange for a payment of rent to the Islamic financiers. For example, a Project company can rent a generator (in a power generation plant) or cranes (in a seaport project) from the Islamic financier while the latter remain the owner of the asset.

MURABAHAH IN PPP PROJECTS

Murabahah is a contract where an Islamic financier purchases an item on behalf of its client from a supplier in the market, and then sells it back to the client with a pre-agreed mark-up. This mode of finance allows to avoid paying interest; therefore, it is considered to be permissible according to *Shari'ah*. Due to its short-term nature, *murabahah* is typically not used for infrastructure finance, which requires long-term financing.

Murabahah is the mode widely used mode of interest-free financing in most Islamic banks to finance the purchase of machinery, equipment, and raw materials. You need to take into account that the mark-up in *murabahah* is part of a sale. The mark-up cannot be changed overtime even if the client defaulted on his debt or was delinquent.

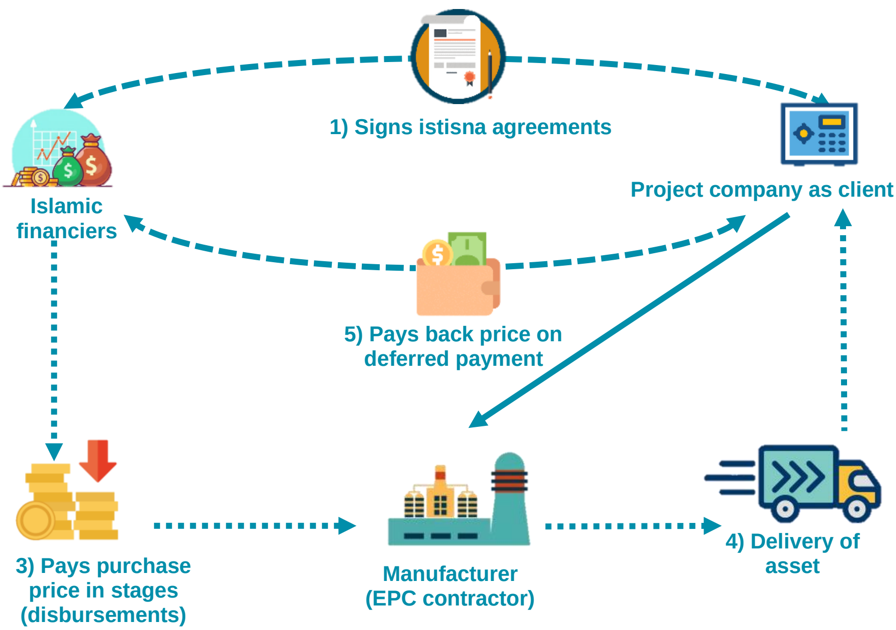
Murabahah Structure and Related Steps



ISTISNA IN PPP PROJECTS

Istisna is an agreement between a purchaser and manufacturer/EPC contractor to construct, build, or manufacture an asset according to the purchaser's specifications and deliver it at a pre-agreed delivery date for a pre-agreed price where payments can be made either in lump sum or installments. *Istisna* is generally a medium-long-term contract and usually used for greenfield infrastructure projects (e.g., a power plant, factory, school, hospital).

Istisna Structure and Related Steps



In PPP projects, the Islamic financier, who acts as a purchaser, appoints the Project company as its agent. Once the infrastructure project is built and accepted by the financier, the financier transfers the title of the asset to the Project company that pays back the sale price of the asset in deferred payments to the financier.

The parties should take into account that the price must be fixed from the outset. If an unforeseen event happens that causes a delay in delivery, the price of *istisna* may be amended by mutual agreement of the parties. Another important note is that once the producer or manufacturer starts the work, the contract cannot be cancelled unilaterally.

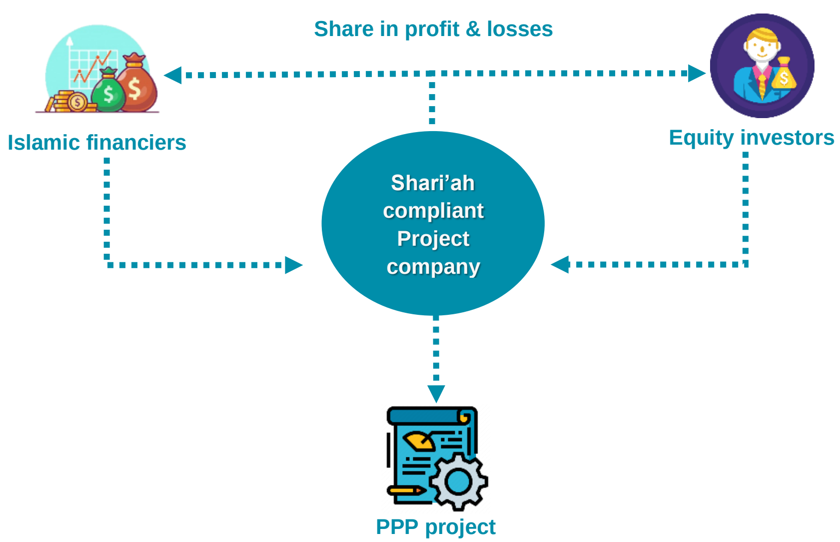
Usually, *istisna* documentation includes the master *istisna* agreement, agency agreement, and corporate guarantee.

MUSHARAKAH IN PPP PROJECTS

The term *musharakah* literally means sharing. In the context of a PPP project, it refers to a joint venture in which the Islamic financiers and equity investors share the profit and loss. In a *musharakah* structure, the proportion of profit to be distributed among the partners must be determined and agreed upon at the time of the contract. You also need to note that the ratio of profit distribution may vary when, for example, some partners only contribute capital to the project. Unlike a profit-sharing ratio, losses are shared by the parties in proportion to their respective investments.

As can be seen, one of the distinctive features of *musharakah* is that it does not envisage a fixed rate of return which means that the return depends on the actual profit earned by the Project company. At the same time, the financier in *musharakah* can suffer loss if the Project company fails to make profit.

Musharakah Structure and Related Steps



MUDARABAH IN PPP PROJECTS

Mudarabah is a contractual relationship executed by two parties where one party provides an investment (*rab al-mal*) and the other one (*mudarib*) provides expertise to manage a business enterprise. In such an arrangement, both parties earn a share of the earnings in a pre-agreed ratio.

However, in case of project failure, only the capital provider (*rabb al-mal*) bears losses. There are, however, exceptions such as negligence or misconduct by the *mudarib*.

In the context of infrastructure PPP projects, investors or Islamic financial institutions may assume the role of a *rab al-ma*l, i.e. a capital provider, while an Islamic bank may act as a *mudarib*. Depending on the mandate provided to *mudarib* by the *the rab al-mal*, an Islamic financier may also take a decision on whether to invest the investors' / Islamic finance institutions' capital in equity- or debt-like instruments.

Mudarabah Arrangement and Related Steps

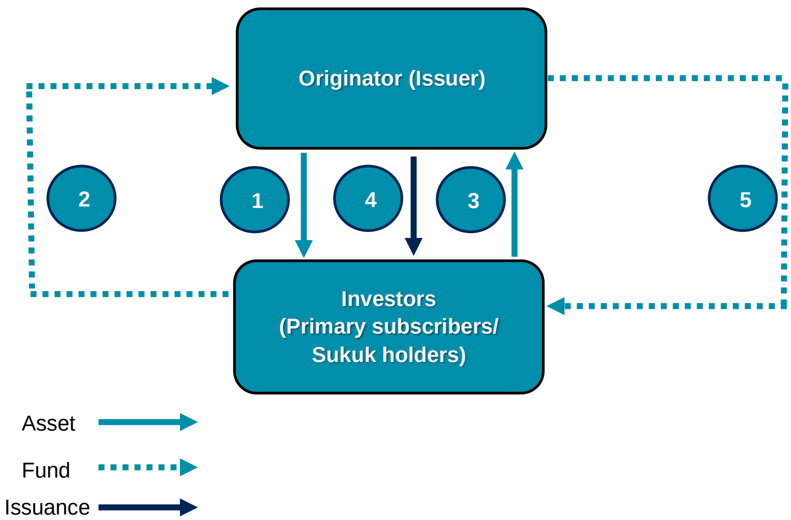
SUKUK IN PPP PRROJECTS

Sukuk is an investment certificate which is used to raise funding from the capital markets and institutional investors. It is different from both conventional bonds, which represent debt obligations of the issuer, and conventional equities, which represent ownership interests in the issuer itself.

Although sukuk is considered to be the most suitable instruments for greenfield infrastructure PPP projects, it can be helpful in Islamic project finance, and sukuk al-Istisna might be of your particular interest.

Diagrams below depict some basic sukuk al-Istisna transaction structures.

Istisna sukuk transaction structure (Model 1)



1. The issuer of sukuk agrees to construct an asset and deliver it to the investors in consideration of an agreed *istisna* purchase price.

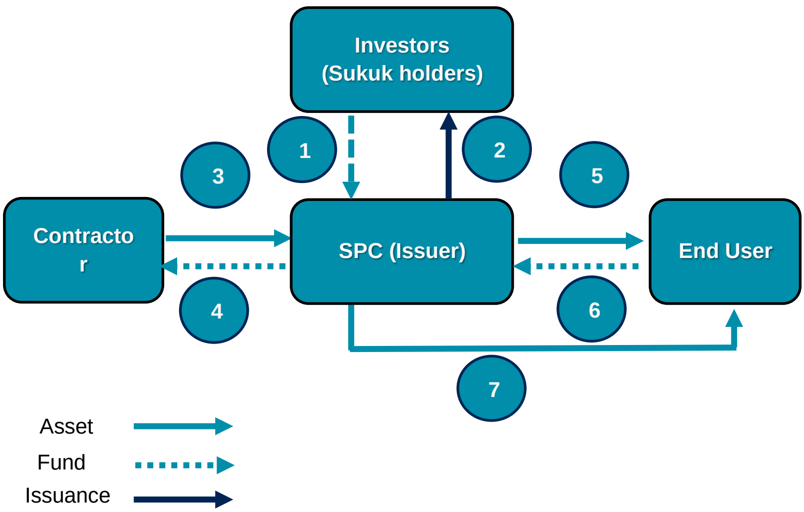
2. The *istisna* purchase would be paid by the investor in one lump sum or in instalments over time. The proceeds are used to finance the project.

3. Investors enter into the second *istișna* transaction (*istișna* sale agreement) and agree to construct the identified *istișna* asset for the issuer. The selling price is made up of the original asset purchase price plus a profit margin payable according to an agreed upon payment schedule.

4. The issuer will issue sukuk to the investors as evidence for the issuer's financial obligation on the settlement of the price.

5. The payment will then be settled on a periodical basis. Sukuk should be redeemable upon maturity.

Istisna sukuk transaction structure (Model 2)



1. Investors provide finance to the Project company for the project.

2. Special purpose company issues sukuk.

3. The Contractor builds/rehabilitate an asset and promises to deliver the asset to the Project company on a specified date.

4. The istisna purchase price is settled on a staged basis and at specified times.

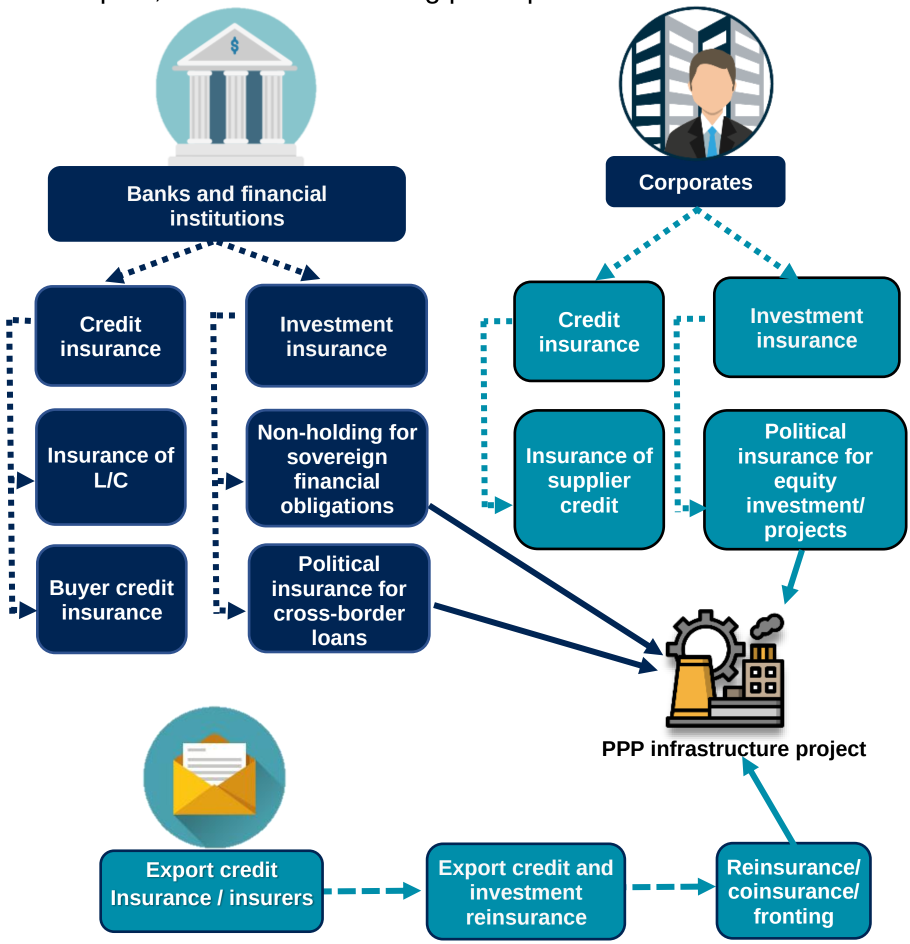
5. During the construction, the Project company leases the *istiṣna* asset under the principle of *ijarah mawsufah fi al-dhimmah* (forward leasing contract).

6. The end user pays the rental to Project company at an agreed formula. Earnings received from the end user are then distributed to investors on a periodical bases until maturity.

7. Upon completion of the project, the asset is sold and delivered to the end user.

TAKAFUL IN PPP PROJECTS

Takaful is a *Shari'ah*-compliant version of insurance. It is one of the key instruments used in infrastructure PPP projects to mitigate the risk of infrastructure PPP projects and cover relevant risks. Under *takaful*, a group of people each contribute to a mutual insurance fund and are all paid out if any one of them incurs losses from the covered risks. If there is a surplus, this is shared among participants.



As of today, there are several institutions offering *takaful* products for infrastructure PPP projects. One of global leaders in takaful operations is the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC). A picture below shows the range of products that ICIEC offers, including those that can be applied in the context of infrastructure PPP projects.

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