



Financial Sector Overview. Russia, CIS and the Caucasus.

powered by

Deloitte.

KPMG

pwc

About us

The Astana International Financial Centre (AIFC) is a project initiated by the first President of the Republic of Kazakhstan to create the leading financial centre in the region (Central Asia, the Caucasus, EAEU, Western China, Mongolia and Eastern Europe). The AIFC focuses on enhancing growth through its main strategic pillars, including Capital markets, Asset management, Financial technology, Islamic finance and Private banking.

For more information, visit our website www.aifc.kz



About any question, please contact:
fintechdepartment@aifc.kz

Foreword

It is my pleasure to introduce the first edition of the *Financial Sector Overview. Russia, CIS and the Caucasus* report.

The report was brought for you by the team efforts of the AIFC and our regional expert partners PwC, Deloitte and KPMG. By preparing the report we aimed to provide you with the up to date statistics, insightful analytics, concurrent trends and developments in the region's economic, regulatory and financial sectors. The report pays special attention to developments of financial technologies in the region, as a potential key driver of the financial and banking sectors.

The financial sector in the CIS and the Caucasus has shown stable and resilient growth over the last few years, with an increasing focus on the adoption of financial technologies to strengthen financial inclusion and improve efficiency and service levels of the financial sector.

Strong digitisation efforts across the region, coupled with rapidly expanding economies, young and digitally-savvy populations, increasing mobile and internet penetration provide significant untapped opportunities for fintech, driven by banks and fintech companies, to accelerate the growth and sophistication of the financial sector.

Continued regulatory developments and government support will be important to ensure the development of the fintech ecosystem. It is positive to note that across the region, regulatory sandboxes have either been established or are in the process of being drafted in legislation, and similarly tax incentives and venture financing are available. We hope that further regional cooperation will strengthen the fintech market and position the CIS and the Caucasus as future leaders in fintech.

We are very thankful to all those who contributed their time and efforts, and made the production of this report possible. We hope that the analysis and insights offered in this report will be helpful to all stakeholders across the financial industry.

Kairat Kelimbetov

The Governor of the Astana International Financial Centre





Contents

| | |
|--|-----------|
| <i>Foreword</i> | 2 |
| <i>Macroeconomic review</i> | 6 |
| <i>Banking Sector Overview</i> | 7 |
| <i>Fintech Sector Overview</i> | 9 |
| <i>Government regulations and support</i> | 10 |
| <i>Case study: Fintech in Kazakhstan</i> | 11 |
| <i>Fintech Ecosystem in Kazakhstan</i> | 12 |
| <i>Tax Regulations Overview</i> | 13 |
| <i>Investment Climate</i> | 15 |
| <i>Acknowledgements</i> | 17 |










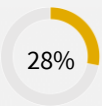
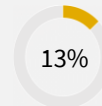
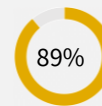
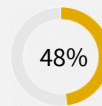
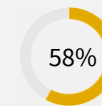
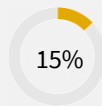
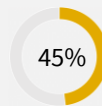
Financial Sector Overview. Russia, CIS and the Caucasus

The information contained in this Report (which does not purport to be comprehensive) has been provided by the AIFC, PwC, Deloitte, and KPMG. The contents of this Report may not be published, reproduced, copied or disclosed. Any reproduction of submitted materials is allowed with the permission of the authors.

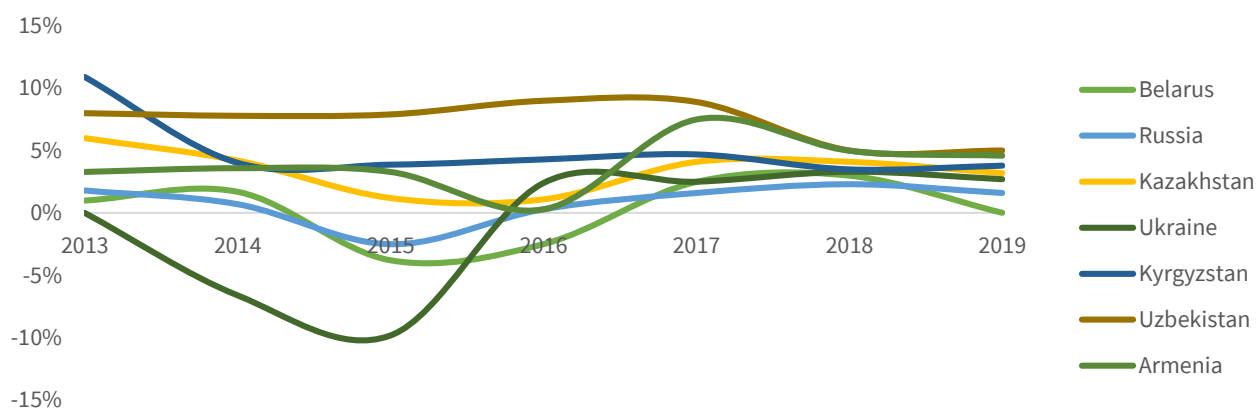
Information used in this document was obtained from public sources. AIFC did not assess the reliability of this information and can not be responsible (either directly or indirectly) for its accuracy and completeness.



Macroeconomic Overview

| Main indexes ¹ |  |  |  |  |  |  |  |
|------------------------------|---|---|---|---|--|---|---|
| Real GDP (2018, \$ bln) | 171 | 1,631 | 125 | 60 | 8 | 41 | 16 |
| GDP per capita (2018, \$) | 9,237 | 11,327 | 2,964 | 6,306 | 1,268 | 1,263 | 4,400 |
| Population, mln | 18.7 | 144 | 41.8 | 9.5 | 6.5 | 33.2 | 3.7 |
| Inflation | 4% | 4.5% | 5.9% | 5% | 2.5% | 18% | 2.6% |
| Domestic debt |  |  |  |  |  |  |  |
| FX and gold reserves, \$ mln | 30,747 | 432,731 | 18,811 | 7,315 | 2,177 | 16 | 3,039 |

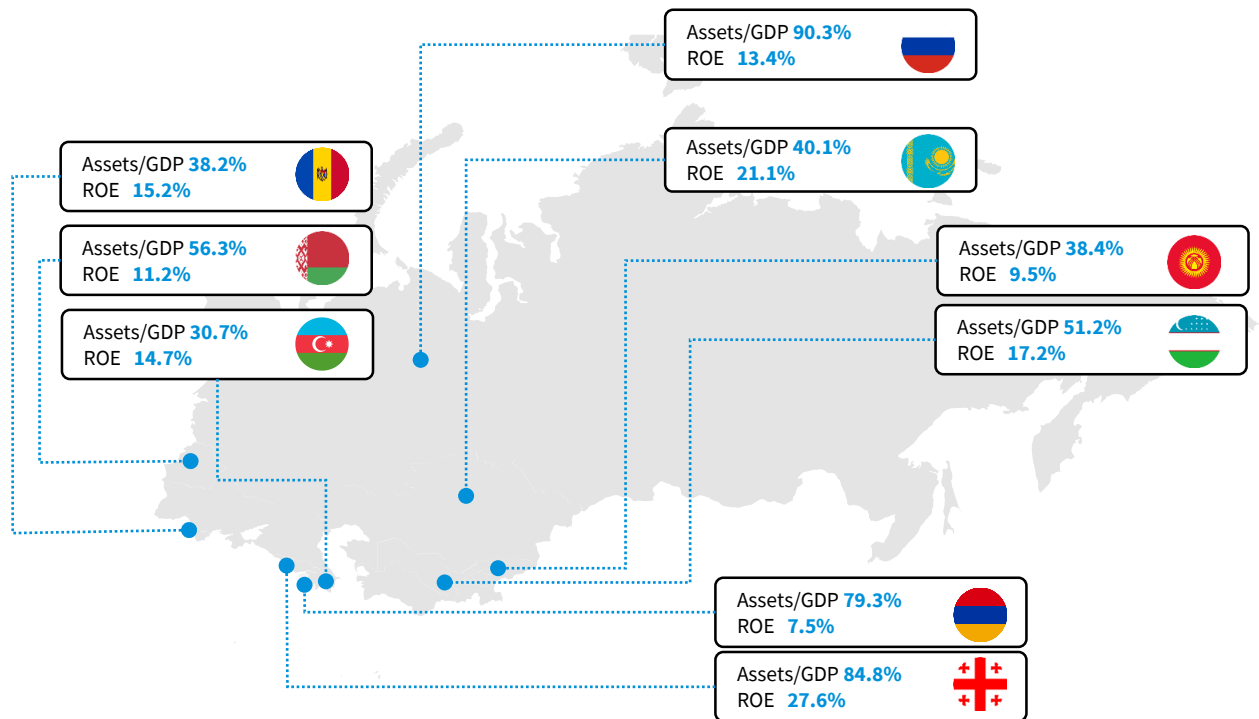
GDP growth¹, % (2010-2019f)



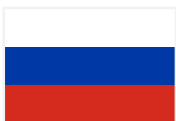
Most economies of the CIS saw favorable economic outcomes in 2018, with accelerating growth and slowing inflation, as external conditions were generally supportive. Commodity prices increased, including oil and other commodities, such as aluminum or cotton, which are important for non-energy-exporting CIS countries. The recovery in the Russian Federation has supported activity across the region via trade and remittance channels. However, the dynamics in terms of trade are likely to be less favorable in 2019. The aggregate CIS growth is expected to decelerate modestly in 2019, as the strong expansion recorded by some of the smaller economies in 2018 may not be sustainable, fiscal policies are growth-neutral at best and monetary tightening is expected in several countries. Aggregate GDP of the CIS and Georgia is expected to increase by 2.0 percent in 2019 and 2.5 percent in 2020. The Russian economy is expected to remain on a low-growth trajectory. Constraints to growth prospects include insufficient business lending, weak investment, banking sector vulnerabilities, and moderately conservative fiscal policy. International sanctions remain a source of uncertainty, deterring investment and raising financing costs.

Banking Sector Overview (1/2)

Key financial indicators of the banking sector in the CIS and the Caucasus



Trends of the banking sector in the CIS and the Caucasus



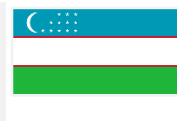
Russian banking sector is expected to stagnate in the medium term.

Highly concentrated and dominated by the state, the Russian banking sector is expected to stagnate in the next 3-5 years. Nonetheless, the fast-growing local fintech industry is putting pressure on banks following the global trend. There are few banks embracing fintech, e.g. Tinkoff and Sberbank.



AIFC activity is gaining its momentum as new initiatives are being undertaken.

A number of banks are participating as partners in Visa Everywhere program looking for innovative solutions. This program is used as a platform, where fintech start-ups and major financial service companies can find opportunities to cooperate, contributing to the development of Kazakhstan's financial sector.



Uzbekistan has opened its economy becoming a gravity center of the investors' interest.

It is expected to attract foreign investors under PPP deals, covering 15 projects worth USD1.66 billion. At the same time, local banks have opened up to foreign investments, attracting high interest from international financial institutions, such as EBRD, ADB, and IFC.



Belarusian banking sector is perceived as a haven of stability.

Compared to Russia and Ukraine, the Belarusian banking sector is considered to be more stable. Many foreign financial institutions, mainly European banks, are expressing readiness to work with Belarus. In addition after a long period of state banks' dominance, the government has shown its intent to privatize a number of banks by 2020.



Main trend in Georgian banking sector is technological innovation.

The country was first in the CEMEA region to issue Visa PayWave payments and is now the second country in the world by the number of face-to-face contactless payments at POSes. In 2018 the first fully digital bank "Space" was opened, and OPBA e-wallet service entered the market. Georgia is also an emerging market for blockchain technologies.

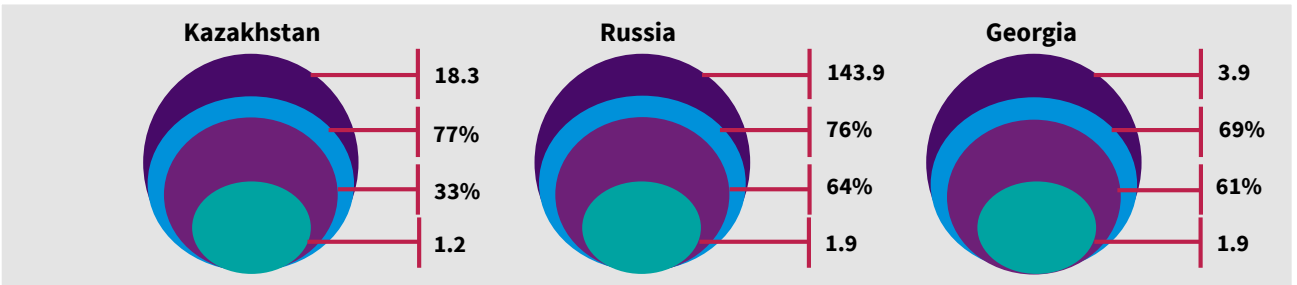


Armenia's banking sector is exclusively private and the regulations are strict.

Armenia's banking sector is characterized by strict bank regulations coupled with prudent behavior of banks: many of banks not only fulfill the Central Bank's requirements but are well beyond them, which was helping local players to avoid default for the past 16 years. Another feature is a high level of dollarization of the banking sector.

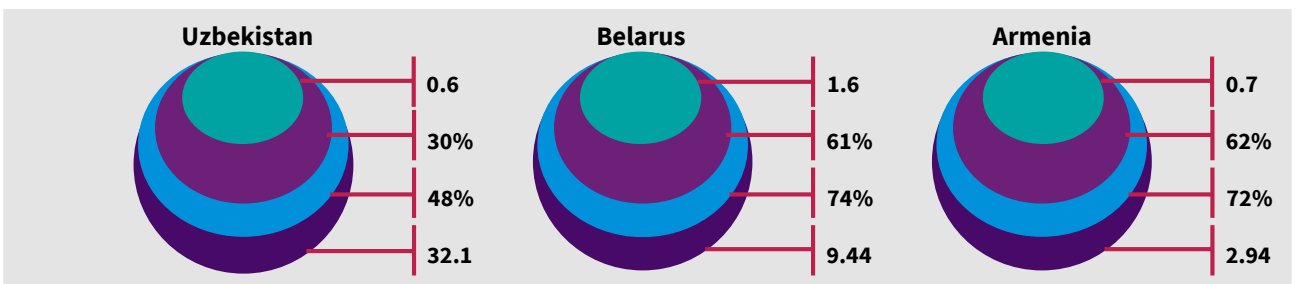
Banking Sector Overview (2/2)

Internet and mobile internet users and number of plastic cards per person

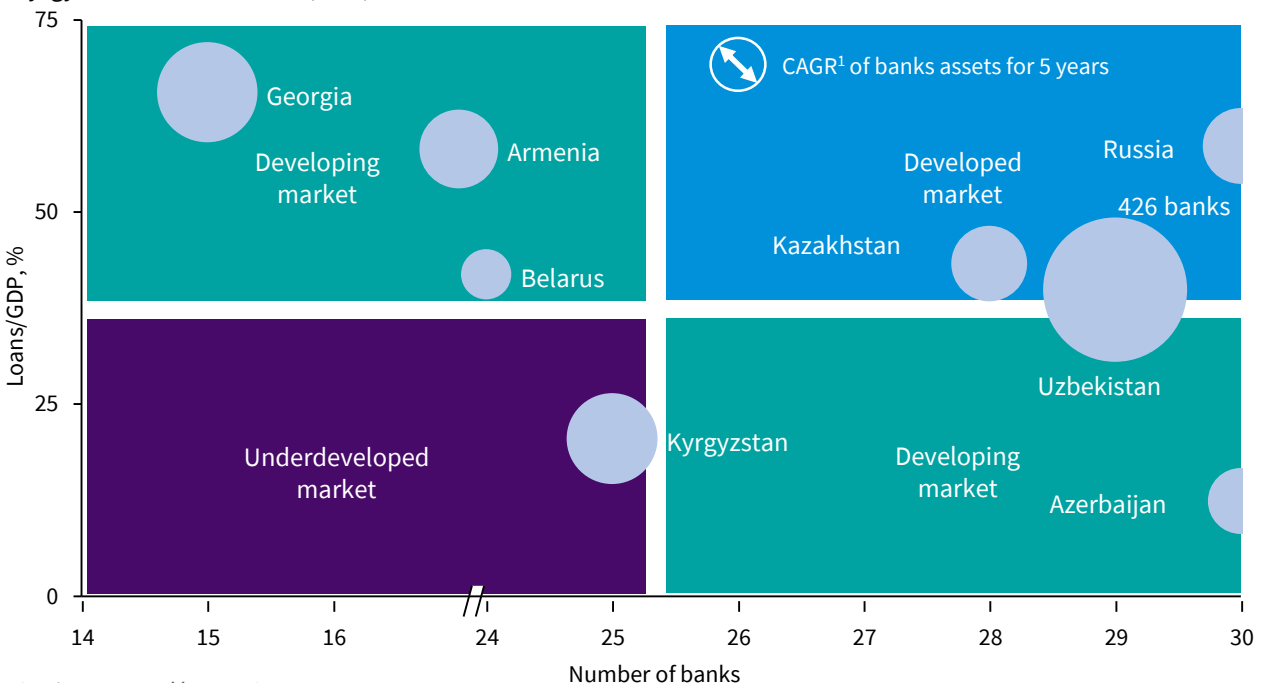


■ Total population, mln
 ■ % of internet users
 ■ % of active mobile internet users
 ■ # of plastic cards per person

Kazakhstan and Russia have the highest level of internet penetration among selected countries, however, penetration of mobile internet is considerably lower in Kazakhstan when compared to Russia. The same tendency is observed in the market for plastic cards. Russia and Georgia are the leaders with the highest penetration of plastic and credit cards, while Kazakhstan has significantly lower penetration of plastic cards. However, during 2018 the number of plastic cards in Kazakhstan has doubled. At the moment Uzbekistan has the lowest penetration of internet and the lowest plastic cards penetration but the market continues to grow since 2017.



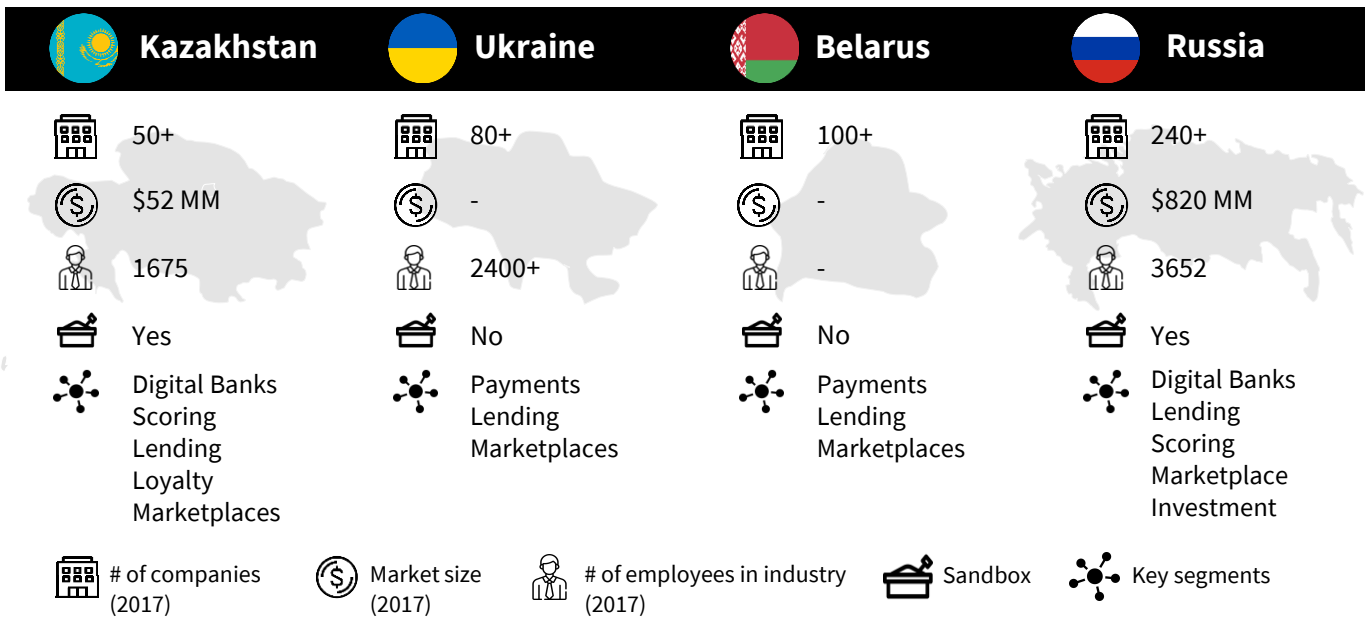
Russia and Kazakhstan have relatively more developed banking markets among countries in the region. Uzbekistan has a moderate loan to GDP ratio despite low credit penetration of the country due to a relatively lower GDP. Out of 6 analyzed countries, Belarus has the highest level of bank account ownership (81%), while Kyrgyzstan has the lowest (18%).



Section prepared by KPMG

¹ CAGR – Compound annual growth rate

Fintech Sector Overview
























Over the past few years, fintech has had a significant impact on the transformation of the global financing sector. The research identified the four most promising segments in the region: payments and lending, digital banking and marketplaces. The development of the above segments in the region depends on the creation and effective operation of the Fintech ecosystem. This can be achieved by means of developing technologies and increasing demand for Fintech services and products through the adoption of a complex of measures aimed at providing capital for Fintech companies and improving the regulatory environment and talent pipeline.

Top development strategies

- Implementation of new technology
- Launch of new products in the market
- Entry into new markets
- Organic growth
- Higher promotion and marketing expenses
- Cost cutting
- Short-term capital optimization and operating model revision

Top barriers

- Low appeal for foreign investors
- Low purchasing power of the population
- Deficiencies of government regulation of the industry
- Geopolitical risks
- Lack of flexibility in the tax system
- Cyber threats
- Currency risks
- Weak protection of the personal data

| | RU | KZ | UA | BLR | GA | UZ | KGZ |
|-------------------------------------|---|---|---|---|--|---|---|
| Global Innovation Rank ¹ | 46 | 74 | 75 | 110 | 62 | - | 101 |
| Business Environment ² | 60 | 64 | 72 | - | - | - | - |
| World Talent Rank ³ | 46 | 40 | 48 | - | - | - | - |
| Access to 3G & 4G ⁴ |  |  |  |  |  |  |  |
| Banked population ⁴ |  |  |  |  |  |  |  |
| Online purchases/bills ⁴ |  |  |  |  |  |  |  |

Section prepared by AIFC Fintech, Deloitte, ID Finance, Займер, Eqvanta, Честное слово


































































1 Global Innovation Index 2018


3 IMD World Talent Ranking 2018


2 Business Environment Rankings 2018 by The Economist


4 Share of population (by We Are Social Global Report 2019)

Government regulations and support

| Technology |  |  |  |  |  |  |
|-------------------------|---|---|---|--|---|---|
| Remote identification |  |  |  |  |  |  |
| Open API |  |  |  |  |  |  |
| Blockchain |  |  |  |  |  |  |
| Artificial intelligence |  |  |  |  |  |  |
| The Internet of Things |  |  |  |  |  |  |
| Cloud technologies |  |  |  |  |  |  |
| Talent | | | | | | |
| Accelerators/Incumbents | 10+ | 10+ | 5+ | 360+ |  |  |
| Capital | | | | | | |
| Government fund |  |  |  |  |  |  |
| VC regulation |  |  |  |  |  |  |
| Regulation | | | | | | |
| Regulatory sandbox |  |  |  |  |  |  |
| Tax privileges |  |  |  |  |  |  |

 No data/no progress - Government has no initiation about law or there is no data about this project

 In progress - Government representatives started to discuss this project

 Ongoing project - There is ongoing draft for this law

 Adopted - Project of this law is successfully adopted

Source: public available sources



Case Study: Fintech in Kazakhstan

Talent:

- A lot of IT and Finance graduates (2000+) from international universities (through Bolashak program)
- BCPD: talent development programs
- Fintech laboratories launched in collaboration with local universities and corporates
- Kazakhstan attracts talent from neighboring talent-rich countries (Russia, Ukraine, etc.) by establishing favorable immigration and the individual income tax regime for foreign employees

Regulation:

- The AIFC Framework is in line with the latest industry developments due to the efficient rulemaking process that allows to modify or adopt new rules in a few months
- A balanced approach to fintech regulation and innovation through first and most active fintech regulatory sandbox in the region aimed at promoting better risk management, competition and faster deployment of Fintech firms to market
- National Bank of Kazakhstan has its own regulatory sandbox

Capital:

- Kazakhstan creates facilities for Private Equity and Venture Funds
- Newly emerged local VC firms (Qaztech ventures, BelnTech, BTS, Global Venture Alliance I2BF) and funds, an increase of angel investor's activity (QazAngels)
- Kazakhstan provides access to traditional and innovative ways of financing and raising capital through regulatory support of crowdfunding and ICO
- Tax incentives for effective capital raising
- Acceleration/ Incubation programs

Demand:

Local clients are actively going online: statistics from 2014 till 2018¹

- the cashless payment volumes increased by 726%
- The number of internet transaction increased by 2365%
- internet payment volumes increased by 7513% (from KZT 5.3 bln to KZT 405.5 bln)
- the POS terminal transactions jumped by 1021%, with the volumes growing just 352%

Other Drivers of Fintech:

- State Digitalization program (Digital Kazakhstan)
- Eurasian Union Sandbox initiation
- Startup boom due to lack of innovation in local banks
- Belt and Road Initiative
- Increase of e-commerce penetration (WAIFC)
- Customers are becoming needy and tech-savvy
- Pro-fintech government (fintech as a pillar) and regulations
- The pipeline of frameworks that will be introduced soon (VC framework, digital banking, payment services)

Fintech Ecosystem in Kazakhstan

Banks*



Regulators



Enterprises*



PE and VC



Hubs, accelerators & associations



Supporters



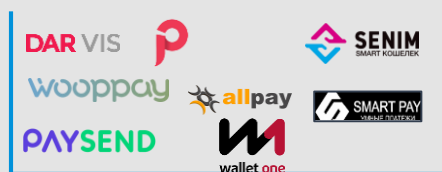
Facilitators



Education



Payment and e-Wallet



Lending



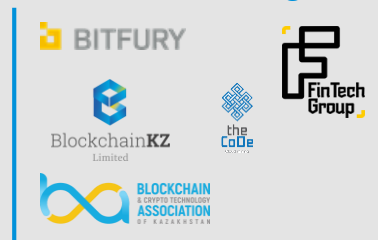
Data & KYC



Solutions



Blockchain & mining



Others**



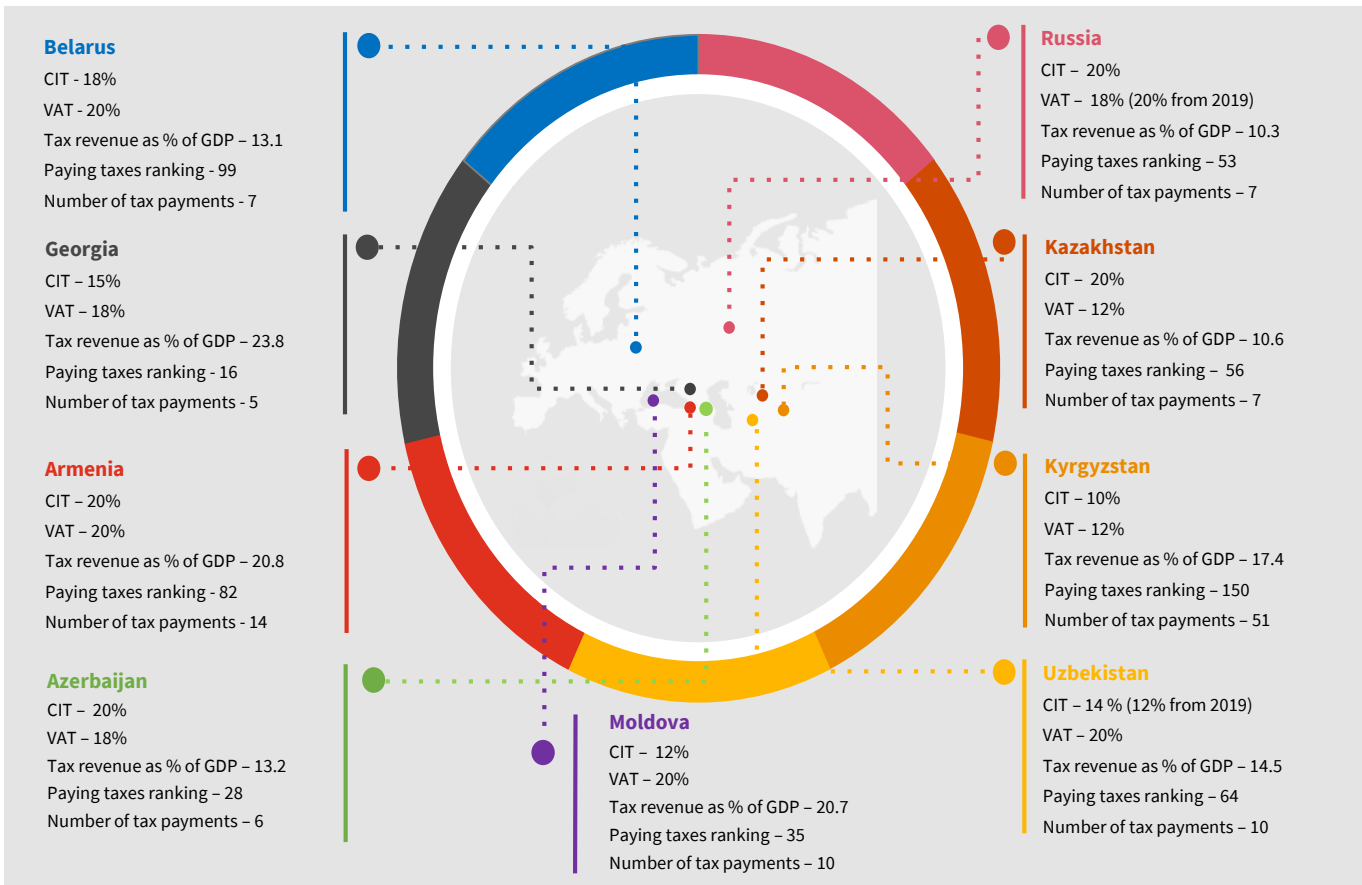
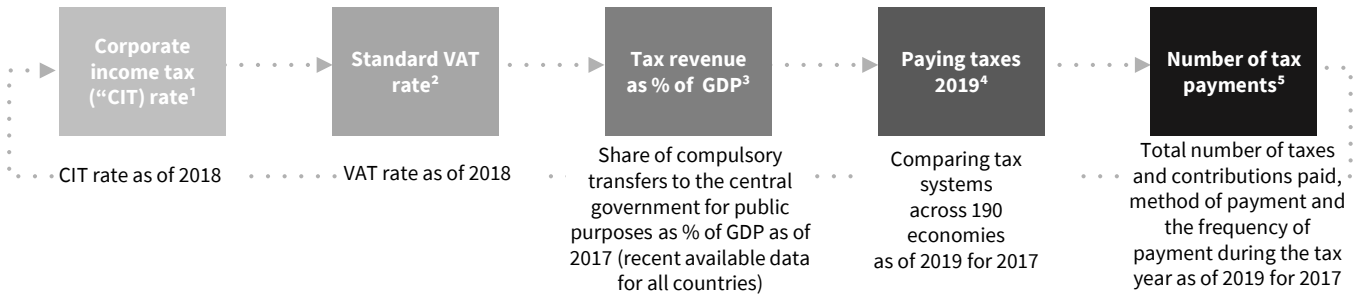
* Banks and Enterprises engaged in fintech

** InsurTech, crowdfunding, marketplace

Tax regulations overview (1/2)

General overview of tax environment

Tax environment of CIS and Caucasus countries (excluding Tajikistan) has been compared by following indicators:



Top countries by tax indicators in the region:

Lowest CIT rate

10%

Kyrgyzstan

Lowest VAT rate

12%

Kazakhstan, Kyrgyzstan

Best ranking in
Paying Taxes

16th

Georgia

Lowest number of
tax payments

5

Georgia

Section prepared by PwC

1 As of FY2018 per countries' tax legislation

2 As of FY 2018 per countries' tax legislation

3 The World Bank 2017

4 Paying Taxes 2019 report by PwC and the World Bank Group

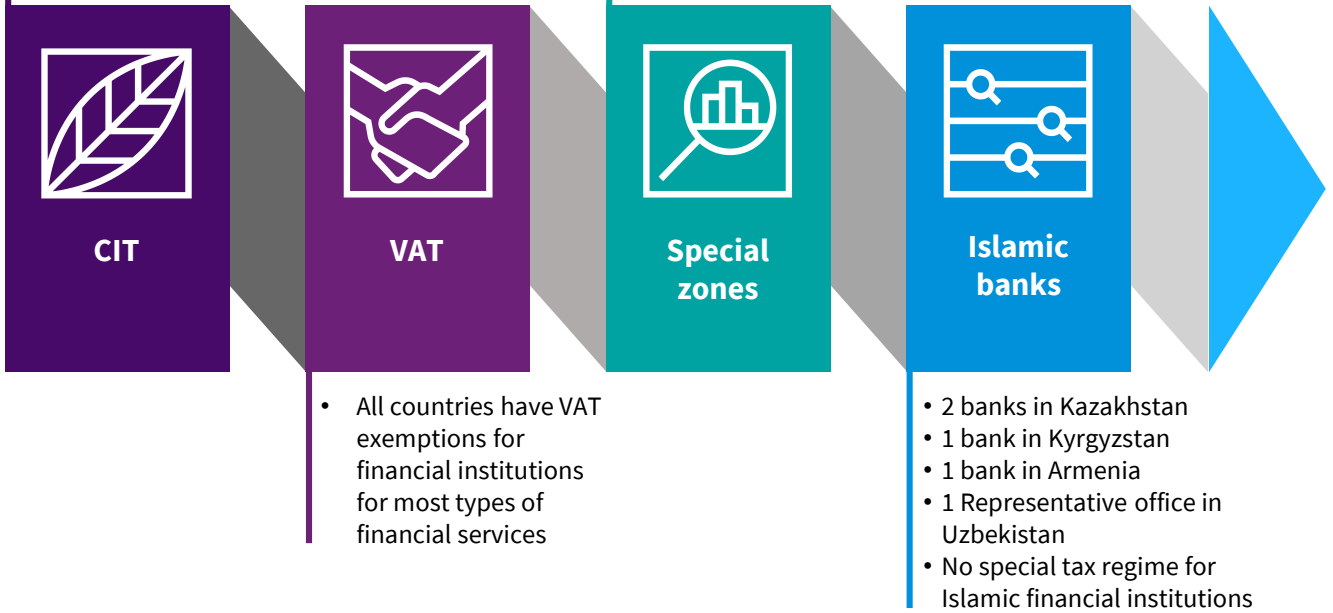
5 Paying Taxes 2019 report by PwC and the World Bank Group

Tax regulations overview (2/2)

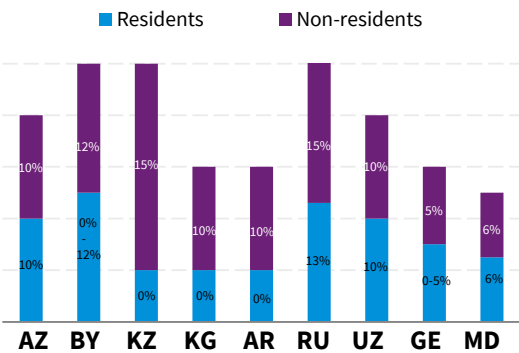
Tax regulations specific to financial market

- Armenia - lower CIT rate for investment and securitization funds
- Kazakhstan, Georgia, Kyrgyzstan, Azerbaijan, Moldova - specific deductions for CIT purposes for financial sector
- Belarus, Uzbekistan – higher CIT rate for financial sector

- Financial hub (AIFC) in Kazakhstan
- Fin Tech - Skolkovo in Russia

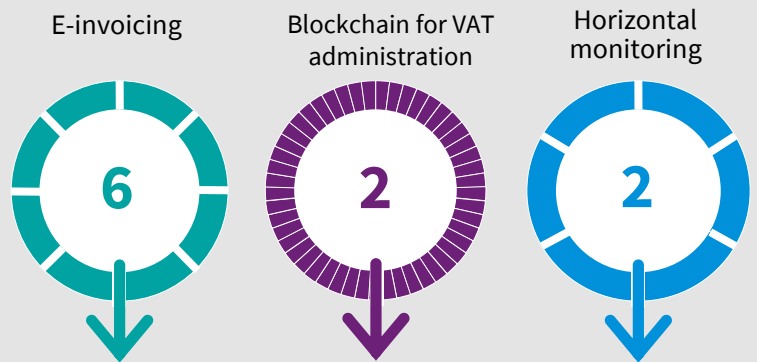


Repatriation of profits (WHT rate for dividends)*



* As of FY2018 per countries' tax legislation

Number of countries with e-initiatives



E - initiatives in tax administration

E-invoicing (electronic billing) - successfully implemented in Kazakhstan, Armenia, Georgia, and Azerbaijan, pilot project in Kyrgyzstan and Uzbekistan

Blockchain (online VAT payment) – roll out process in Kazakhstan, APUS system in Azerbaijan

Horizontal monitoring (cooperation based on trust between business and tax authorities) - roll out process in Kazakhstan, successfully implemented in Russia

Investment Climate (1/2)

World Bank's Doing Business 2019 Ranking

| | 2008 | → 2019 | ✓ Best Dimensions | ✗ Dimensions Requiring Reforms |
|-----|------|--------|---|--|
| UZ | 138 | 76 | <ul style="list-style-type: none"> ✓ Starting a business - 12 ✓ Getting electricity - 35 | <ul style="list-style-type: none"> ✗ Trading across borders - 165 ✗ Obtaining construction permits - 134 |
| UA | 139 | 71 | <ul style="list-style-type: none"> ✓ Getting credit - 32 ✓ Dealing with construction permits - 30 | <ul style="list-style-type: none"> ✗ Resolving insolvency - 145 ✗ Getting electricity - 135 |
| KGZ | 94 | 70 | <ul style="list-style-type: none"> ✓ Registering property - 8 ✓ Obtaining construction permits - 29 | <ul style="list-style-type: none"> ✗ Getting electricity - 164 ✗ Paying taxes - 150 |
| BLR | 110 | 37 | <ul style="list-style-type: none"> ✓ Registering property - 5 ✓ Getting electricity - 20 | <ul style="list-style-type: none"> ✗ Paying taxes - 99 ✗ Getting credit - 85 |
| RU | 106 | 31 | <ul style="list-style-type: none"> ✓ Registering property - 12 ✓ Getting electricity - 12 | <ul style="list-style-type: none"> ✗ Trading across border - 99 ✗ Protecting minority investor - 57 |
| KZ | 71 | 28 | <ul style="list-style-type: none"> ✓ Protecting minority investor - 1 ✓ Enforcing contracts - 4 | <ul style="list-style-type: none"> ✗ Trading across borders - 102 ✗ Getting electricity - 76 |
| GA | 18 | 6 | <ul style="list-style-type: none"> ✓ Protecting minority investor - 2 ✓ Starting a business - 2 | <ul style="list-style-type: none"> ✗ Resolving insolvency - 60 ✗ Trading across borders - 43 |



KZ

S&P - BBB-
Moody's - Baa3
Fitch - BBB

4,634 mln\$
FDI inflows

6.98%
FDI share in GDP

In the past two decades, Kazakhstan has become a major destination for foreign investment, mainly directed to resource-based industries. Between 2008 and 2017, average FDI of out of GDP is 6.98%, which, was mainly driven by resource-based industries. Coal, oil and gas represented 54% of the cumulative FDI inflow of the last decade and metals and minerals came close to 10%. In 2015-2016, FDI in oil, and gas represented 17% of the total in the sector worldwide. However, despite the relatively high level of FDI in the sector, many of the country's resources remain relatively untapped.



RU

S&P - BBB-
Moody's - Baa3
Fitch - BBB-

25,284 mln\$
FDI inflows

2.42%
FDI share in GDP

FDI flows into Russia have been on the decline since 2013, due to geopolitical tensions between Russia, Ukraine, and the Western countries. While inflows rose to USD 37.1 billion in 2016, they fell once again in 2017 to USD 25.3 billion, the second lowest level since 2006. The share of FDI in the GDP remains relatively low in view of the country's growth and economic potential. In recent years, Russia has undertaken economic reforms, but administrative problems, corruption, and uncertainties about regional stability have remained major challenges.



UA

S&P - B-
Moody's - Caa1
Fitch - B-

2,202 mln\$
FDI inflows

3.65%
FDI share in GDP

In addition to political instability, investors have pointed out the underlying inefficiency and corruption in the legal system as one of the main disincentives for investment. The complexity of legislation and regulation, poor contract enforcement and poor governance constitute other serious impediments. In 2018, the main investors in Ukraine were Cyprus, the Netherlands, United Kingdom, Germany, and Switzerland. The investment was primarily aimed towards manufacturing, trade and repairs, real estate and financial and insurance activities

Investment Climate (2/2)



S&P - BB-
Moody's - B1
Fitch - BB-

96 mln\$
FDI inflows

1.65%
FDI share in GDP

FDI inflows slightly decreased drastically in 2017 to USD 96 million. FDI traditionally arrives from Russia, South Korea, China, and Germany, but Canada increased its financial presence in 2018. Investments focus on the energy sector, including alternative/renewable energy in recent years. Uzbekistan ranked 76th in the World Bank 2019 Doing Business, including a ranking as the 12th easiest country to start a business in. The country also ranks 158th out of 180 countries in Transparency International's Corruption Perceptions Index 2018. The Government's policy of establishing seven special economic zones with tax breaks for investors has made the country attractive to international capital.



S&P - BB-
Moody's - Ba2
Fitch - BB

1,862 mln\$
FDI inflows

9.27%
FDI share in GDP

FDI flows to Georgia in 2017 reached US 1.8 billion (+ 16% year-on-year). Although FDI picked up again, the recovery from the 2014-2015 recession remains modest due to the geopolitical concerns. More than 30% of incoming flows are related to extractive industries. As for trade and finance, they attract respectively 20% and 11% of FDI inflows. Azerbaijan is the largest investor in the country because of the ongoing construction of the Shah-Deniz pipeline. More than half of FDI inflows in 2017 come from Europe, mainly from Cyprus and Luxembourg. UNCTAD estimates that FDI flows into Georgia will grow moderately in the coming years, supported by rising commodity prices and stronger economic growth. To attract investors, the country offers tax and legislative advantages. Corruption, historically very present in the intermediate levels, has been largely eradicated - a major obstacle in attracting FDI.



S&P - B
Moody's - B3
Fitch - B

1,276 mln\$
FDI inflows

3.16%
FDI share in GDP

In 2017, net inflows of FDI amounted to about US 1.27 bln, slightly higher than in 2016 (+ 3.1%) but still below the level in 2014. The net inflows have recovered slightly thanks to the increase in trade of oil in 2017. The main foreign investors in 2017 in Belarus are Russia, the United Kingdom, and Cyprus. The most attractive sectors for foreign investors are transportation, communications, computer technology, real estate, agriculture, financial operations, building, and machinery manufacturing. In early 2018, Belarus announced that it would improve its investment conditions for IT companies in order to develop the digital economy.



Moody's - B2

94 mln\$
FDI inflows

7.40%
FDI share in GDP

FDI flows to Kyrgyzstan amounted to US 94 mln in 2017, a significant decrease from US 616 mln in 2016. According to the Minister of Economy, the main reason for the decline is the strong dependence of FDI related to the Kumtor gold mine. Indeed, oil production has fallen sharply and expectations for 2018 are not positive. In addition, investors fear higher taxes and put some investment projects on hold. Most FDI flows have been to mining-related activities and other sectors such as finance, petroleum product manufacturing, but in general, FDI to non-core activities mining remains weak. The main investors in Kyrgyzstan are Canada, China, the United Kingdom, Russia, and Kazakhstan. Since 2017, China and Kyrgyzstan have signed more than 10 investment agreements worth US 1.81 bln.

Acknowledgments



Lora Nakoryakova

Research Center Leader
Deloitte CIS
E-mail: lnakoryakova@deloitte.ru



Saken Zhumashev

Managing Partner
Head of Management and Risk
Consulting
KPMG in Kazakhstan and Central Asia
E-mail: szhumashev@kpmg.kz



Bolat Mynbayev

Associate Director
Head of Strategy and Operations
Group
KPMG in Kazakhstan and Central Asia
E-mail: bmynbayev@kpmg.kz



Michael Ahern

Partner
Leader of Tax & Legal Services
PwC Eurasia
E-mail: michael.ahern@pwc.com



Amirkhan Chikanayev

Expert
AIFC Fintech Department
Tel.: +7 777 333 99 77
E-mail: a.chikanayev@aifc.kz



Ainur Zhanturina

Senior Manager
AIFC Fintech Department
Tel.: +7 702 217 73 51
E-mail: a.zhanturina@aifc.kz

Contact information



[linkedin.com/company/aifcfintech](https://www.linkedin.com/company/aifcfintech)



[@FintechAifc](https://www.facebook.com/FintechAifc)



[@aifc_fintech](https://twitter.com/aifc_fintech)



[@aifc_fintech](https://www.instagram.com/aifc_fintech)



t.me/fintechkz
t.me/fintechhub



fintech.aifc.kz



fintechdepartment@aifc.kz

