

**DRAFTING OF SYNDICATED LOAN AGREEMENTS IN KAZAKHSTAN
IN LIGHT OF INTERNATIONAL EXPERIENCES – RECOMMENDATIONS AND
CHALLENGES TO LAW**

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Abstract

The aim of this thesis is to assess the legal possibilities for implementing international experience in syndicated lending schemes within the legal system of Republic of Kazakhstan.

In order to achieve that aim the I analyze the current international experience, figure out its main peculiarities, solutions for potential problems that may arise, determine the legal nature of syndicated lending transactions and the relationship inside syndicate and observes the other regarding issues. Based on that analysis I juxtapose international scheme to the legal reality of Kazakhstan in order to define whether syndicated lending could be implemented or not. As a result a set of problems and risks has been defined that make such scheme of financing unattractive and even more risky in comparison with separate lending. Thus in order to eliminate them, I provide certain recommendations.

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Introduction

“I, for my part, am sure that by the year of 2030
Kazakhstan would have become a Central-Asian Snow Leopard
and would serve a fine example to be followed
by other developing countries”¹

According to both local and foreign experts the economic growth of Kazakhstan is very much dependent on the export of mineral resources and quite negatively reacts on decrease of their prices in the world market². Therefore the idea of diversification becomes more and more actual for Kazakhstan reality. Diversification and industrialization of country is one of the major goals that declared by the State. In light of that objectives numbers of strategic plans and state programs on innovative industrial development have been implemented. According to them re-orientation of economy to the export of processed products with high additional value instead of raw materials, improvement of transport infrastructure in order to efficiently benefit from attractive transit potential of Kazakhstan, development of agriculture are awaited³.

Obviously that such a tremendous incentive requires significant financial resources. They might be provided either by the state itself or might be raised with involvement of private capital

¹ Nursultan Nazarbayev, *The Strategy for Development of the Republic of Kazakhstan until the year 2030*, available at http://www.akorda.kz/en/category/gos_programmi_razvitiya (last access 03-03-2014)

² For example, please see the World Bank's Kazakhstan country economic memorandum *Beyond Oil. Kazakhstan's Path to Greater Prosperity through Diversifying.* / June 2013, available at <https://openknowledge.worldbank.org/handle/10986/16719> (last access on 03-03-2014); or Revyakin S., *Vlianie mirovogo finansovogo krizisa na ekonomiku Kazakhstana (Influence of the Global crisis on economy of Kazakhstan)*, 4 Kazenergy journal, available in Russian at <http://www.kazenergy.com/ru/2012-06-20-08-42-46/2012-06-29-06-19-22/6294-2012-01-19-09-45-06.html> (last access on 03-03-2014)

³ For example, please see *Strategy "Kazakhstan 2050": New Political Course of the Established State*, available at <http://www.kazakhembus.com/document/address-by-kazakhstan-president-nursultan-nazarbayev-strategy-kazakhstan-2050> (last access on 03-03-2014), *Strategic Plan for Development of the Republic of Kazakhstan until the year 2020*, available in Russian at http://www.akorda.kz/en/category/gos_programmi_razvitiya (last access 03-03-2014)

either throughout bank loans, stock market, or venture capital. In that situation banks seem more likely to participate, because neither stock market nor venture capital market is developed enough in Kazakhstan⁴. However huge amounts of money imply greater risk, which seriously affects the willingness of banks to provide loans in large amounts. In such situations syndicated lending scheme can satisfy their desires by allowing them to get involved in the loan while mitigating the risk. May be therefore exactly “[syndicated lending] has played a key role in the growth and development of companies and countries in both developed and emerging markets”⁵.

At the same time, implementation of such schemes depends on demand from borrowers, supply from banks and existence of an appropriate legal base. Whereas demand and supply are the market elements with some distancing from the state, the legislation is the direct “product” of the state. Therefore if the state does not make steps towards improvement of the Law by mirroring the market’s need, there will be no evolution of the economy. On the other hand if there is no demand, then there is no need for legislative innovations.

So maybe there is no need for syndicated loans in Kazakhstan at all? No, there is. For example, exactly within the framework of innovative industrial program in 2011 Kazphosphate LLC (Kazakhstan company) raised a loan in amount of USD 50 million provided by two kazakh banks – HSBC Bank Kazakhstan and ATFBank as so called “syndicated loan”. The loan was provided for construction of a sulfuric-acid producing plant. The launching of the plant ensures the processing of virgin raw material – sulfur, into a sulfuric acid, and, moreover, power

⁴ Dodonov V.Y., *Mirovoi krizis i tendenzii ekonomicheskogo razvitia Kazakhstana (Global crisis and tendencies of economic development of Kazakhstan)* 56 (2011), available in Russian at <http://www.kisi.kz/site.html?id=8044> (last access on 03-03-2014)

⁵ Saurabh Mukherjea, *The syndicated loan market in emerging markets, in Syndicated Lending. A Handbook for Borrowers in Emerging Markets* 3 (Saurabh Mukherjea ed., 1999)

production at the expense of steam, which is escaping during the processing⁶. Nevertheless the deal was closed successfully it was an extremely bureaucratic process for both the banks and the customer. Arrangement of the credit took much time due to existence of certain deficiencies and restrictions of law which forced the banks and the customer either to adjust additional risk mitigating mechanisms (where it was possible) or to assume the risks (where it was impossible to reduce them contractually). In addition, the law required the customer to collect and provide the same documents in hard copies for each bank separately and the registration of the pledge doubled the customer's efforts in essence of time and expenditures because of necessity to perfect security interest on the name of both banks⁷.

Thus, consequently in such a situation, when the Law does not allow for simplifying the procedure and reducing the risks, the attractiveness of that form of financing would vanish accordingly. Therefore it is necessary to observe more deeply what should be the solutions within the current legal framework and what should be altered in order to eliminate the obstacles. In that respect, it is important try to analyze existed Kazakh legislation in light of international experience, in order to understand what possibilities Kazakh Law provides for implementation syndicated lending scheme there.

For that purposes the present thesis is divided to two chapters. In the First chapter I explain briefly the main characteristics of syndicated lending transaction, analyze a legal nature of it, the main principles and tools that helps to achieve the aims of that type of financing. The Second chapter is devoted to analysis of syndicated lending in Kazakhstan, its distinctions from the

⁶ The news on this deal are available in Russian at http://www.interfax.kz/?lang=rus&int_id=zh&news_id=8547 and http://www.rusmining.ru/view_news.php?id=19757&page=561 (last access on 03-03-2014)

⁷ Security interest was perfected on the name of the banks one after another, therefore the process of registration was held twice.

It is needed to note, that I was attended in all the major negotiations on the side of one of the banks (for legal support) and was one of the drafters of all the documents for that deal. Therefore I have precise awareness of that deal.

international experience and possibilities to implement needed mechanisms mitigating the risks. Also it shows what risks and problems can occur due to some gaps or ambiguity in legislation. In Conclusion I try to summarize the problems and make recommendations for their resolving.

Chapter 1. Overview of syndicated lending scheme in international market

1.1. Definition and main characteristics of syndicated lending

In order to understand what the syndicated loan is, one need to define its essential distinctive characteristics. The first and most obvious feature of this type of financing is that it implies the existing of group of creditors, i.e. syndicate. In this sense, the syndicate concept for some extent coincides with the definition given in the Black's dictionary, according to which, the syndicate is "a group organized for a common purpose; especially, an association formed to promote a common interest, carry out a particular business transaction, or (in a negative sense) organize criminal enterprises"⁸. However, not every syndicate suggests an existence of syndicated lending scheme. For instance, a group of creditors that agreed with each other to provide loans to its' customers with not less than a certain level of interest rate, might be recognized as a syndicate for the purpose of antitrust legislation in most of jurisdictions. Nevertheless, this type of syndication and lending wouldn't be a syndicated lending as it is understood in practice.

So what is a syndicated lending? In order to answer this question, it is necessary to define the following main characteristics of such deals. They are the following⁹:

- as stated above – the existence of group of creditors organized for the concrete deal;
- the loan is provided by this group of creditors to one or more borrowers (not potential, but existing borrowers);
- the loan is provided on the basis of common agreement or several agreements derived from the common deal (for instance, sometimes the structure of the deal may consist of a

⁸ Black's Law Dictionary 1490 (8th ed. 2004)

⁹ Please see for example Philip R. Wood, *International Loans, Bonds and Securities Regulation* 94 (1995)

multiple agreements and inter-creditor agreement);

- several obligations to creditors, thus, none of creditors is liable for breach of obligation by the others;
- certain level of joint control, or so-called syndicate democracy principle, according to which the creditors delegate certain power to make decisions jointly by the majority of votes;
- benefits sharing, meaning that any proceeds received by the creditor should be proportionately divided between the creditors according to amounts owed to them;
- centralization of money flow through the agent.

The most important among them is the severality principle which mirrors the main idea of the whole deal – concentration of financial resources without imposing additional risks on the participants. Obviously, no bank would enter into syndicated lending if there is a probability of commitment for the entire amount of credit declared to the borrower, unless the risk is justified by a significant increase of credit costs. However, the same increased costs might “stifle” borrower’s interest in borrowing.

So, we can say that syndicated loan is the loan based on the severality principle of creditors that meets other abovementioned characteristics.

1.2. *LEGAL NATURE OF SYNDICATED LENDING*

For a proper implementation of syndicated lending within the relevant legal system, it is necessary to distinguish the types of legal relationships embraced by that transaction.

Syndicated loan is not a mere loan between creditors and borrowers. It is a mix of different legal relations complicated by the multitude of parties and different contractual elements within the

common deal. Therefore, the syndicated lending should be considered as having manifold contractual nature.

First of all, it is a loan transaction. Thus, all the requirements for lending schemes should apply to the syndicated lending as well.

Additionally, syndication implies some level of cooperation or association of creditors inside a group in order to achieve a common purpose. Hence, there are also legal relationships which derive from this joint activity. Depending on regulating law, these relationships might be treated differently, either as mere contractual cooperation or as a consortium or a partnership, i.e. form of unincorporated organization. Consequently it might put additional liabilities on creditors. For example, a partnership under the English Law may “lead to fiduciary duties between parties (such as full disclosure and avoidance of conflicts of interest), reciprocal indemnity liabilities, and special insolvency and tax regimes”¹⁰.

Besides that, syndicated lending also requires agency relationships between the whole group and a designated agent (usually one of the creditors within the syndicate). Agent usually acts on behalf of creditors and does not represent the borrower.

1.3. PARTICIPANTS TO SYNDICATED LENDING

Usually, there are following participants referred to within syndicated deals:

- the Borrower
- the Arranger
- the Agent

¹⁰ Id.

- the Security Trustee (if the loan is secured).

- the Creditors

The Arranger's role is to organize a syndicated credit facility for the Borrower. Usually the Arranger is a bank which is familiar with the market, regulating law and other conditions necessary to a successful completion of a deal. This allows it to find creditors interested in a deal, offer optimal conditions for both borrowers and creditors, provide certain consulting services to borrowers including consultation on documentation. Additionally, the Arranger prepares the Information Memorandum, the document used as a basis for potential investors to make their decision on entering or rejecting the deal. Therefore it "must cover all the issues which will be important to interested banks in their evaluation of the credit"¹¹. It's important to note that all the significant information necessary to make the Information Memorandum is provided to the Arranger without any need for channeling it to all the other potential creditors.

Another important function of the Arranger is to act as an intermediary during contract negotiations between borrowers and creditors. In this regard the professionalism of the Arranger may prove useful. The Arranger should know not only how to protect the creditors' risks, but also be able to propose admissible solutions if potential disputes occur during the negotiations. Although the legal firms are engaged in process of drafting the contracts, the Arranger has to predict the possible reactions of the parties for either conditions of the agreement from the initial step in order to successfully close the deal. The Arranger can receive a fee for its services, usually from the Borrower.

¹¹ Mark Campbell, Christoph Weaver, *Syndicated Lending: Practice and Documentation* 276 (6th ed. 2013)

In case of successful formation of the syndicate, the Agent is chosen as an intermediary for all the relationships between the parties to administer the deal. “Agent may not be the bank that arranged the facility in the first place, but it is quite common for this to be so”¹².

Agent acts as a representative of the creditors and bears certain liabilities. Summarizing several opinions, the functions of the Agent might be generalized into following¹³:

- Paying agency: directing payments from creditors to the Borrower and vice-versa;
- Rate fixing: fixing floating rate basis for the floating rate loans;
- Monitoring: observing performance of certain obligations (including condition precedent compliance test). However, there are few differences in some authors’ views in this regard. For example, though Mark Campbell and Christoph Weaver agree with condition precedent duties, they, nevertheless, say that the Agent has no obligation “to monitor or enquire upon event of default” and only obliged to inform upon his awareness of the facts. On the contrary, the “Guide to Syndicated Loans” mentions that an Agent “monitors the compliance of the borrower with certain terms of the facility”. However, anyway since the relationship between the agent and the creditors is based on the agreement, the obligations would depend on the provisions thereof;
- Information and documentation transferring: channeling the documentation and/or notices from the borrower to the creditors and vice-versa;

¹² Kevin Murray, *The term sheet, in* Syndicated Lending. A Handbook for Borrowers in Emerging Markets 41, 47 (Saurabh Mukherjea ed., 1999)

¹³ For detailed explanations please see *A Guide to Syndicated Loans & Leveraged Finance Transactions*, published by the Loan Market Association, available at <http://www.lma.eu.com/pages.aspx?p=317> (last access 03-03-2014); or Claire Ingram, *After the signing, in* Syndicated Lending. A Handbook for Borrowers in Emerging Markets 111, 111-120 (Saurabh Mukherjea ed., 1999); or Mark Campbell, Christoph Weaver, *Syndicated Lending: Practice and Documentation* 311-17 (6th ed. 2013)

- Record keeping: maintain the database on syndication deal participants and the history of transactions between them;
- Event of default duties: making necessary steps according to the agreement and instructions of the syndicate in occurrence of event of default.

Agent can also carry out functions of the Security Trustee, although it is not prohibited to select a Security Trustee among other creditors in syndicate. Its role is to hold security interest on behalf of all the creditors and perform other liabilities connected to the security such as, for example, keeping the documents, enforcement of security interest, etc. There is no need to perfect security interest on the name of each creditor separately because the Security Trustee holds the interest on behalf of all creditors and is obliged to act in favor of each one of them. Therefore, a new creditor, to whom the relevant part of the credit is assigned, would have a security interest without any additional actions in regard to perfection¹⁴.

It has to be noted that depending on the deal structure some other functions of an Agent might also be separated and transferred to other participants that act as agents for particular tasks. For instance, the duties of the designated Documentary agent relate only to the work with documentation, or the Administrative agent will perform a separate function of collecting and transferring payments.

Creditors in syndicated lending are distinguished as primary creditors (lenders or banking institutions) and secondary creditors (investors). Those who fall under the primary level enter the original deal with certain commitment to provide a credit facility and sign the original agreement. Since they are expected to grant a credit, banks often become primary creditors. However, in

¹⁴ *A Guide to Syndicated Loans & Leveraged Finance Transactions*, published by the Loan Market Association, available at <http://www.lma.eu.com/pages.aspx?p=317> (last access 03-03-2014)

practice they might also be quasi-banking companies, which are allowed to provide loans and some other financial services as the regular banks. Their participation depends on applicable legislation and existing practice. The secondary creditors are any entities that are allowed to acquire debts. Usually they are investment institutions, funds, pension funds, hedge funds, insurance companies and others¹⁵.

1.4. CONDITIONS ENHANCING EQUALITY BETWEEN CREDITORS IN SYNDICATE

Taking into account the number of creditors, the creditors always bear a risk of losing their money due to unequal ranking of their claims, lack of access to the borrower's assets, etc. For example, there might be a situation when one of the banks is repaid fully while the other still have a certain outstanding amount owed by the borrower.

Therefore, the mechanism of pro-rata sharing is broadly used in order to prevent disproportional distribution of proceeds. According to this rule, any excessive amount (i.e. gains that are greater than a portion that should have been received if the gains were distributed proportionally within the whole group) received by one creditor should be "shared proportionally without discrimination"¹⁶. Thus, this mechanism reduces the risks of disproportionality and unfairness between creditors.

The mechanism of pro-rata sharing implies a subrogation of debts owed by the borrower from the creditors that receive their portion to the sharing creditor. So the creditor that shares the proceeds

¹⁵ For example, Barry Bobrow, Mercedes Tech and Linda Redding in *An Introduction to the Primary Market in The Handbook of Loan Syndications and Trading* 157, 164-69 (Allison Taylor, Alicia Sansone eds., 2007) divide the investors on two types – Pro Rata Investors and Institutional Investors. Under the meaning of Pro Rata Investors fall commercial banks, universal banks and investment banks. Under the other category fall non-bank investors, like structured funds known as CLOs, mutual funds known as prime-rate funds, finance companies, insurance companies, hedge funds and others.

¹⁶ Philip R Wood, *supra* note 9, at 91

receives the relevant portion of the debt in exchange and replaces the creditors against the borrower in respect to those debts. Consequently, debts owed by the borrower to a particular creditor are increasing, whereas those owed to others are proportionally decreasing. However, such possibilities might be restricted by the regulating legislation¹⁷.

Additionally, syndicated lending provides a certain shift of decision making power from the individual level to the group level. It is also based on the necessity to protect other creditors from decisions that might be acceptable for particular creditors, but disadvantageous for the whole syndicate. Thus, according to that principle “the banks may agree between themselves to delegate limited decisions to majority control, e.g. certain waivers of non-payment obligations and the right to accelerate the loan on an event of default”¹⁸.

Certain defense from potential risks is also achieved by the perfection of the security in favor of the Security Trustee, instead of each creditor separately. The Security Trustee has special obligations to distribute proceeds from enforcement between all the creditors whose claims are secured by that security. All of the security interests held by the Security Trustee are treated as equal and no creditors have more advantageous positions against the others. Apart from that, the existence of the Security Trustee allows to avoid additional actions on perfection of the security interest in case of substitution of the creditor (transfer of debt to others)¹⁹.

1.5. TYPES OF FACILITIES USED IN SYNDICATED LENDING

¹⁷ *Id.* at 97

¹⁸ *Id.* at 91

¹⁹ For more detailed explanation of functions and nature of Security Trustee please see Philip R Wood, *Comparative Law of Security Interests and Title Finance* 75-85 (2nd ed. 2007)

Depending on its renewability after repayment the credit facility is usually divided into two following types: non-revolving and revolving²⁰.

Non-revolving means that each drawdown is deducted from the whole loan limit, thereby decreasing the available sum to be used further. A repaid amount is not provided to the borrower again.

On the other hand, revolving facility provides an availability of repaid amount for the borrower within the limits of the credit facility. Thus, all the repaid amounts from a revolving part can again be given to the borrower.

By types of credit instruments the following are applied to the syndicated lending²¹:

- term loans;
- trade finance instruments, such as letters of credit and guarantees;
- standby facilities, such as standby letter of credits, standby loan facility.

Considering the risk sharing aspect by all the syndicate members of the syndicated lending, providing any of such facilities should be organized in a way that would involve all the syndicate members.²² Hence, issuance of term loans requires transfer by each participating bank of its appropriate portion to the Agent for further provision of it to the borrower. Repayment of the loan is also made through the Agent who distributes relevant amounts among all the creditors depending on their participation share.

²⁰ For more detailed explanation please see Roger Uttery del Corral, *Types of syndicate facilities in Syndicated Lending. A Handbook for Borrowers in Emerging Markets* 27, 34-40 (Saurabh Mukherjea ed., 1999)

²¹ For more detailed explanation please see for example Uttery del Corral, *supra* note 20;

²² For more detailed explanation please see for example Richard Wight et al., *Understanding the Credit Agreement in The Handbook of Loan Syndications and Trading* 209, 211-17 (Allison Taylor, Alicia Sansone eds., 2007)

Contingent liabilities of banks such as letters of credit or guarantees do not require immediate availability of money and, therefore, participation in such instruments differs from loans. Since the execution of letter of credit or guarantee is subject to certain circumstances, the future issuing bank does not incur any expenses at the moment of issuance. However, such bank bears risks of executing such instrument if it is called by the beneficiaries. Therefore, other participating banks undertake the obligation of participating in the execution of the letter of credit or guarantee by reimbursement of the relevant proportion to the issuing bank in case of paying of such contingent liabilities when it is due.

The purpose of syndication also affects a composition of facility by the types of instruments. Thus, if the purpose is the further selling of the credit to institutional investors who do not provide loans, then it is probable that revolving facilities or trade finance instruments will not be included into the structure.

Besides that, it is important to keep in mind that contingency liabilities like letters of credit or guarantees do not create a debt on the borrower at the moment of issuance. Usually the borrower is obliged to return expended amounts to the issuer after the execution occurred. But before the bank is called for execution the obligation of the borrower is not occurred. Thus, acceleration implies only a repayment of factual outstanding debt, and an enforcement of the security will cover only such amounts. At the same time the bank is not discharged from its obligations to execute issued letter of credit or guarantee until their expiration. As a result, it also can influence the combination of syndicated facility structure in terms of its instruments.

1.6. COVENANTS USED IN SYNDICATED LENDING

As any other regular loan agreements, the syndicated loan agreement also contains covenants. Usually they are divided into following groups²³:

- Financial covenants;
- Affirmative covenants;
- Negative covenants.

While financial covenants require a support of certain financial ratios on defined level (i.e. without any specification of concrete actions), affirmative and negative covenants are associated with certain actions. For example, affirmative covenants imply the fulfillment of different obligations by the borrower, such as providing the information, reports, taking out insurance, obeying the law or ecologic standards, and other. Negative covenants, in contrary, are restricted to perform some actions or activities, such as property pledge without prior consent of creditors, dividend payments, capital expenditures, mergers and acquisitions, restrictions of *pari passu* and other.

However, it should be noted, that covenants do not guarantee high defense of creditors' interest in case of their breach by the borrower. For instance, a breach of the negative pledge does not cancel or diminish security interest of another creditor only on the ground of the absence of consent of the creditor that imposed a negative pledge. At the same time in some jurisdictions, particularly in the United Kingdom for instance, such creditor is allowed to claim compensation for damages from pledgee "for the tort of procuring a breach of contractual relations"²⁴, if he was aware of existence of negative pledge covenant.

²³ For more detailed explanation please see for example *id.* at 297-327

²⁴ Philip R Wood, *supra* note 9 at 38

Therefore, the main purpose of covenants is to provide the creditor with the possibility for demand of early repayment of the whole outstanding amount in occurrence of specified events or breach of obligations and termination of credit agreement rather than just creating a security interest on the property of the borrower or imposing the real blocks for borrower's actions. In syndicate the issue on acceleration usually transfers to the majority vote, thus, use of covenants for early repayment by a separate lender is reduced.

1.7. SECURITY AND SUBORDINATION IN SYNDICATED LENDING

Depending on the structure of the deal a loan can be covered by security or may be unsecured. The security might be of different types. The pledge and guarantee are the main and often-used types.

Usually there is a wide variety of different types of property that could be pledged as collateral, such as equipment, immovable property, money, receivables, inventory, grain and other types. As mentioned earlier, security interest is generally held by the Security Trustee in favor of all the creditors within the syndicate.

The guarantee might be provided either by an individual or companies depending on the applicable law.

Without a doubt, the main purpose of the security is to secure a performance of its obligations by the borrower and to avail the creditors with the possibility to recover a debt from the security. However, the security may be necessary also for regulatory requirement purposes. For example, in some countries classification of the loan and its provision depends on existence and value of

the security²⁵. The smaller value of the security leads to the higher classification requirements and provision level. Therefore, the absence of the security could result in additional costs depending on provisioning.

Besides the security, it is needed to notice about the possibility to use such option as subordination. Subordination infers an agreement between different level creditors on change of their claims priority. Wood explains two main methods of subordination – turnover subordination and contractual subordination. In turnover subordination junior creditor undertakes the obligation to return to senior creditor all the amounts received from the debtor, sufficient to cover all the debts owed by that debtor to senior creditor. There are two means of accomplishing such relations between senior and junior. The first implies the use of trust scheme where junior holds all the payments received from the debtor for the benefit of senior creditor. The second implies contractual obligation of the junior to pay the senior all the payments received proportionally to debts owed by the debtor. So it means that the junior creditor becomes contractually bound to pay as a separate debtor of the senior creditor. In contractual subordination creditors contractually change the ranking of their claims – so junior creditor stands in ranking after senior creditor²⁶.

1.8. LOAN TRANSFER AND PARTICIPATION

Usually banks when providing loans contemplate the possibility of further selling of them to the third party. In some cases this might even be the main goal - to sell the loan and make additional profit out of administration services. For example, in Kazakhstan there is a hypothec credit system that is provided for the purchase of hypothec credits from banks by a single government-

²⁵ For example see World Bank's survey *Bank Loan Classification and Provisioning Practices in Selected Developed and Emerging Countries*, 2002, available at <http://info.worldbank.org/etools/docs/library/154927/financeforum2002/pdf/bankloanclassification.pdf> (last access on 03-03-2014)

²⁶ Philip R Wood, *Project Finance, Subordinated Debt and State Loans* 43-6 (1995)

owned operator (“Kazakhstan Hypothec Company” JSC). At the same time after an acquisition of credits they remain with the banks which render administration services for a certain fee. As a result banks refinance their loans and use received amounts for further crediting, meanwhile receiving a certain fee from the abovementioned operator²⁷. Therefore, banks are highly motivated to sell the loans and indeed grant them with the initial goal to do so.

Since the syndicated loan is a credit, the creditors might be interested in transferring their portions to the third parties as well. The reasons may be different, which can be grouped into the following²⁸:

1. Regulatory reasons – to maintain certain capital ratio requirements and/or other regulatory requirements.
2. Financial reasons – to raise money or to crystallize a loss. For example, it might be profitable for the creditor to refinance the loan in order to use money for further lending, while continuing to obtain benefits from this refinanced loan acting as a payment agent for the new creditor for a certain fee. In regards of crystallization it might be necessary to get back the outstanding amount at a discount as well as to release the money which is “frozen” as a provision.
3. Risk management reasons – to reduce the risks occurred in connection with “particular market sector, geographic region or country, industry or even customer by virtue of

²⁷ For more detailed information please see information note at National Bank of Republic of Kazakhstan web-site at <http://www.nationalbank.kz/cont/import/word/docimport30205.doc.html> (last access on 03-03-2014)

²⁸ For example see “A Guide to Syndicated Loans & Leveraged Finance Transactions”, published by the Loan Market Association, available at <http://www.lma.eu.com/pages.aspx?p=317> (last access on 03-03-2014); and Graham Franklin, *The secondary market in Syndicated Lending. A Handbook for Borrowers in Emerging Markets* 131, 132-34 (Saurabh Mukherjea ed., 1999); and Mark Campbell, Christoph Weaver *Syndicated Lending: Practice and Documentation* 489-490 (6th ed. 2013); and Philip R. Wood, *International Loans, Bonds and Securities Regulation* 104 (1995)

overall exposure or changes in the political or economic environment”²⁹.

The main methods of transferring the loan or its part are the following³⁰:

1. Novation – creditor transfers of all the rights and obligations derived from the loan or its part to the third party. So novation means a substitution of the creditor as a party in agreement;
2. Assignment – the creditor assigns the rights derived from the loan or its part to the third party for a certain consideration. Obligations of the assignor still remain with him and he is obliged to fulfill them properly;
3. Sub-participation – might be funded or unfunded. Funded implies the deposit of the fund from the third party (investor) to the creditor with the obligation of the latter to return it. It is subject to payments that the creditor receives from the borrower. Due to the fact that the third party bears double risk, there is also an additional fee payable by that third party to the creditor for such risk. Unfunded participation means only transfer of the risk, therefore, it is also called the “risk participation”. According to this scheme the investor undertakes the obligation similar to a guarantee to repay the debt of the borrower as the event of default occurs. No transfer of funds or channeling of payments is required. However, since the investor bears a risk it receives a risk fee from the creditor.

²⁹ Graham Franklin, *id.* at 132

³⁰ Please see “A Guide to Syndicated Loans & Leveraged Finance Transactions”, published by the Loan Market Association, available at <http://www.lma.eu.com/pages.aspx?p=317> (last access 03-03-2014); and Graham Franklin *supra* note 28 at 140-151; and Mark Campbell, Christoph Weaver, *supra* note 28 490-511; and Philip R. Wood, *supra* note 28 at 104-118

CHAPTER 2. ANALYSIS OF POSSIBILITIES TO IMPLEMENT SYNDICATED LENDING SCHEMES IN KAZAKHSTAN

2.1. WHAT IS THE SYNDICATED LENDING ACCORDING TO KAZAKH LAW

Kazakhstan legislation contains the definition of syndicated loan only in the Rules of credit documentation maintenance³¹ (hereinafter referred to as “Rules of credit documentation”), which serve to regulate banking activity in the sense of formation of credit dossier and maintenance of documentation associated with the credit operations. According to these Rules of credit documentation, the loan jointly formed and provided by two or more banks that are members of banks syndicate to the borrower (group of affiliated borrowers) on the ground of one loan agreement (attaching to it the other documents if necessary) fall under a syndicated loan. Syndicate is understood as two or more banks joint with the purpose of carrying out of joint credit operations and reduction of potential losses for every participant in case of insolvency of the borrower, subject to retention of legal and financial independence of banks within the syndicate³².

Besides that the Rules of credit documentation also contain the definition of the Agent bank which is a bank that represents syndicate members and executes syndicated loan administration services³³.

Thus, according to the abovementioned definitions, the syndicated loan under Kazakhstani legislation is the loan that meets the following characteristics:

³¹ Pravila vedenia dokumentatsii po kreditovaniyu ot 23.02.2007 N49 (The Rules on credit documentation management), available in Russian at <http://adilet.zan.kz/rus/docs/V070004602> (last access on 03-03-2014)

³² *Id.* paragraph 1

³³ *Id.*

- multitude of bank-creditors;
- common loan agreement (attaching to it the other documents if necessary);
- existence of the Agent bank which represents the syndicate members and executes the credit administration services;
- common borrower or group of borrowers.

Clearly, an existence of the most important principle of the syndicated lending, the severality of creditors, is not a key for syndicated lending in Kazakhstan. Hence, even normal loans with the multitude of creditors with joint and several liabilities are treated as syndicated loans. Although it contradicts the main purpose of syndication, which is risk sharing, nevertheless, it might have logical justification. The definition of the syndicated lending consisted in the Rules of credit documentation focuses primarily on the procedure of credit documentation formation rather than on the nature of the relationships between the creditors. For these purposes, the character of the relationships within the syndicate and existing forms of liability do not really matter. The presence of the multitude of creditors as subjects that form a credit dossier is considered to be in the foreground.

However, it might lead to the question, whether it is possible to establish the severality principle contractually, or does syndicated loan by default imply joint and several liabilities on creditors. In order to answer this question it is necessary to analyze common and special norms of the Kazakhstani legislation.

According to the article 382 of the Civil Code of the Republic of Kazakhstan, the counterparts are eligible to determine contract conditions, unless certain conditions otherwise specified by the

legislation³⁴. In addition, according to the article 380 of the Civil Cod, the parties to the contract are allowed to conclude a contract independent of the legislation³⁵. The Kazakhstani legislation does not contain any prohibitions to combine different independent liabilities between different creditors and borrowers into one common agreement. On the other hand, such a combination might lead to an assumption of occurrence of multiple parties on the creditors' side. Then according to the article 269 of the Civil Cod of the Republic of Kazakhstan, the entire shared, joint, and several or secondary liabilities arise on the creditors' side³⁶. Nevertheless, according to the articles 285, 287 and 288 of the Civil Cod, the regulation of the abovementioned liabilities, their occurrence and cancellation might be a subject to an agreement between creditors and borrowers³⁷. Thus, banks in the syndicated lending can contractually determine severality of liabilities of each bank/party, thereby implementing severality principle.

Although the legal definition covers the severality principle, it does not make any reference to the other two important principles – a syndicate democracy and a pro rata sharing. Thus, it is important to understand whether it is possible to implement these principles through an agreement.

A syndicate democracy is, in fact, a waiver of certain decision making rights by the creditors in favor of the common majority. Although this principle is not widely spread within the legal practice of Kazakhstan, a possibility of its implementation is embraced by the Civil Cod of the Republic of Kazakhstan. According to the article 2 of the Civil Cod, individuals and legal entities

³⁴ Grazhdanskiy kodeks Respubliki Kazakhstan (Obshaya chast) (Civil codex of Republic of Kazakhstan (Common part)), article 382, available in Russian at <http://adilet.zan.kz/rus/docs/K940001000> (last access on 03-03-2014)

³⁵ *Id.* article 380

³⁶ *Id.* article 269

³⁷ *Id.* articles 285, 287, 288

may waive their rights and are free in their establishment based on agreement³⁸. Nevertheless, apparently courts are inclined to restrain the individual creditors from making decisions independently, even though it was conferred on the common majority level. Decision making power might be treated as the right guaranteed by the Law, exercising of which is dependent only on entity's will. Thus, the right of decision making might be waived voluntarily by simply not exercising it. However, it is not obligatory to waive this right in the future, thereafter freely exercising the right.

In regards to a pro rata sharing, it is important to note that the Kazakhstani legislation allows using such means of contractual relationship. According to the article 276 of the Civil Cod of the Republic of Kazakhstan, a performance of the entire obligation or its parts might be imposed on a third party³⁹. Thus, each syndicate member by the contract relies on a borrower's obligation to repay the loan proportionally equal to the amounts owed to other creditors in case of any exceeded sums received by a certain creditor (i.e. according to the pro rata sharing principle). However, most importantly, according to certain peculiarities of the Kazakhstani legislation, implementation of this principle faces certain problems, which are explained further.

2.2. LEGAL NATURE OF SYNDICATED LENDING ACCORDING TO KAZAKH LAW

Similarly to the international practice syndicated lending scheme, the Kazakhstani syndicated lending system also comprises several legal relationships. Generally, it includes a credit relation between the creditors and a borrower as well as those between the creditors themselves.

³⁸ *Id.* article 2

³⁹ *Id.* article 276

As for the credit relationships, the bank's lending operations in Kazakhstan are regularly subject to licensing⁴⁰. Therefore, in order to be a member of a syndicate the bank has to receive an appropriate license.

Additionally, being a bank loan, a syndicated loan has to meet certain statutory requirements. So according to the article 728 of the Civil Cod of the Republic of Kazakhstan, the loan agreement has to be written, otherwise it is considered void⁴¹. Besides that, as stated in the section three of the Rules of credit documentation, the original copy of the loan agreement that terminated without the use of the standard form approved by the authorized bank or with the change of this form without approval of the authorized bank, must be signed by the head of legal services of the bank (or by the lawyer in the bank's branch) and by the parties, and has to be ensealed by the borrower and the bank⁴². Generally, the syndicated loans do not fall under the regular standard banking products (at least in Kazakhstan), therefore, there is a limited likelihood that the banks have a standard form of the syndicated loan agreement. Moreover, the banks can involve legal firms that have experience in these or similar schemes in order to represent their interests during the negotiation process. In that case a participation of "internal" lawyers could be diminished significantly. It is ambiguous then whether the signatures of these "internal" lawyers make any sense after their detachment from the negotiation processes. Absence of the lawyer's signature neither affects the validity and enforceability of the agreement nor implies that the legal risks are not observed properly. Therefore that procedure seems to be absolutely pointless and burdensome

⁴⁰ According to article 6 of Zakon Respubliki Kazakhstan "O bankakh i bankovskoi deyatel'nosti v Respublike Kazakhstan" ot 31-08-1995 N2444 (Law on banks in Republic of Kazakhstan), available in Russian at <http://adilet.zan.kz/rus/docs/Z950002444> (last access - 03-03-2014) and article 32 of Zakona Respubliki Kazakhstan «O litsenzirovanii» ot 31-01-2007 №214-III (Law on licensing) available in Russian at <http://adilet.zan.kz/rus/docs/Z070000214> (last access on 03-03-2014)

⁴¹ Grazhdanskiy kodeks Respubliki Kazakhstan (Osobennaya chast) (Civil codex of Republic of Kazakhstan (Special part), available in Russian at http://online.zakon.kz/Document/?doc_id=1013880 (last access on 03-03-2014)

⁴² *Supra* note 31 paragraph 3

in terms of time and costs which might eventually have an effect on the timeframe of closing the deal.

In addition, the Kazakhstani legislation imposes requirements to the language, textual format and consequence of conditions of the agreement. According to the Resolution N18 (hereinafter referred to as “Resolution”) of the Financial Supervision Agency dated February 28, 2011, the loan agreement must be written in Kazakh and Russian languages or in Kazakh and acceptable for the parties language in case of the presence of a foreign party. It should be printed out on the A4 paper size sheets, using “Times New Roman” font with the minimum font size of 12, font normal spacing, paragraph single-spaced and indentation. The following conditions are mandatorily required to insert on the first two pages of an agreement (or in case when the agreement is expressed on two languages simultaneously with dividing the sheet onto two columns, then they should be placed on the first four pages):

- date of closure of an agreement;
- total amount and currency of the loan;
- terms of the loan;
- type and size of interest rate, size of annual effective interest rate calculated in order prescribed by the National Bank of Kazakhstan;
- order of calculation of floating interest rate (in case of the use of floating interest rate);
- means of repayment;
- method of repayment;
- the priority of paying the debt;

- order of calculation and size of penalty for overdue payments⁴³.

Certainly, these requirements are established for consumer protection in order to avoid situations when essential conditions are hidden within the complicated structure of a contract. However, taking into account that syndicated lending does not involve individuals or small companies, but rather big corporations that have possibilities to adequately assess all the risks related to the deal, it is not justifiable to spread some of mandatory requirements to the syndicated schemes.

Besides the requirements to the agreement, the Kazakhstani legislation also contains some mandatory rules on documentation which must be mandatorily provided to the banks within the syndicate for the purposes of formation of the credit dossier and revealing beneficiary owners. According to the section 29 of the Rules of credit documentation, the borrower is obliged to provide the lenders with the same package of documents. Notably, it is prohibited to form one common credit dossier by the Agent bank only. Moreover, certain documents are required to be provided in the original form or/and notarized copies of them (for instance, incorporation documents must be presented in notarized copies, business plan or technical-and-economic assessment - in the original copy).

The relationship between the creditors is divided into two types – inter-creditor relations and agency relations between all the creditors and the agent.

In the inter-creditor relations, according to the Kazakhstani legislation, a syndicate may be recognized as a consortium. The Civil Cod of the Republic of Kazakhstan determines the

⁴³ Postanovlenie Pravleniya Agentstva Respubliki Kazakhstan po regulirovaniyu i nadzoru finansovogo rinka i finansovikh organizatsiy ot 28-02-2011 N18 "Ob utverzhdenii perechnya obyazatelnykh usloviy dogovora bankovskogo zaima i vnesenii dopolneniy i izmeneniy v postanovleniye Pravleniya Agentstva Respubliki Kazakhstan po regulirovaniyu i nadzoru finansovogo rinka i finansovikh organizatsiy ot 23-02-2007 N49 "Ob utverzhdenii Pravil vedeniya dokumentatsii po kreditovaniyu", (Resolution on requirements for bank loan agreements) paragraph 10, available in Russian at <http://adilet.zan.kz/rus/docs/V1100006877> (last access on 03-03-2014)

consortium as a temporary association of legal entities, which is not a legal entity itself, and which implies consolidation of its participants' resources and coordination of efforts for resolving certain tasks. At the same time consortium members retain their economic freedom⁴⁴.

Matching the definition of a consortium to the abovementioned definition of a syndicate, it is notable that both of them coincide to each other and have the same characteristics:

- both imply association of legal entities (i.e. banks) without creation of a new legal entity;
- both imply consolidation of resources;
- both have a certain purpose.

Therefore, it is possible that a syndicate of the bank can be considered exactly as a consortium, i.e. a partnership formed by the legal entities (as a form of unincorporated organization).

Such a consequence could impose a serious negative impact on the members of a syndicate. According to the article 230 of the Civil Cod of the Republic of Kazakhstan, the property created or acquired as a result of joint activity of consortium members becomes their joined shared owned property⁴⁵. Additionally, in accordance with the article 210 of the Civil Code, their shares are considered as equal, unless the Law or agreement states otherwise⁴⁶. Thus, an absence of the precise share determination equalizes the shares independently from participation proportion in the whole credit amount. This results in equally-shared payment amounts unless the agreement between the memebbers specifies otherwise⁴⁷. Besides that, according to the article 231 of the Civil Code of the Republic of Kazakhstan, the procedure of loss covering must be specified in the

⁴⁴ *Supra* note 34 article 233

⁴⁵ *Supra* note 34 article 230

⁴⁶ *Supra* note 34 article 210

⁴⁷ *Id.*

agreement between consortium members. Otherwise both the common expenses and losses are covered from the common property and deficient amounts are divided among the members proportionally to their shares in common property⁴⁸. Particularly, if the shares are not defined properly, the division is made on the assumption of the shares equality.

Additionally, the character of consortium relations imposes certain restrictions on the further disposition of the share in the consortium, i.e. a share of the entire syndicated loan. According to the article 216 of the Civil Code of the Republic of Kazakhstan, the owner of the share who is planning to sell it has to offer his share to the other co-owners first, according to the preemptive right rule⁴⁹. Thus, it significantly influences subsequent transfers of loans by the syndicate members.

Speaking about the agency relationship, it is important to note that in international practice the agent acts for a fee. In Kazakhstan, however, every commercial activity into which a bank is engaged is a subject to restrictions imposed by the legislation. The Law of the Republic of Kazakhstan “On banks and banking activity in the Republic of Kazakhstan” (further on referred to as “The Law on Banks”) specifies the exhaustive list of activities in which the bank could be involved with commercial purposes⁵⁰. The service as a representative of third parties on issues connected to banking operations that could be used as a justification for receiving fee is the closest to the agency function of syndicates. So, in Kazakhstan it is possible to be a syndicate agent for a fee. However, further transfer of loans by the banks to other non-bank investors may cause some problems. According to the Article 30 of the Law on Banks, providing banking and

⁴⁸ *Supra* note 34 article 231

⁴⁹ *Supra* note 34 article 216

⁵⁰ Law on banks in Republic of Kazakhstan, *supra* note 40 articles 8 and 30 contain the exhaustive list of operations which are allowed to be carrying out by the banks on the payment basis. Available in Russian at <http://adilet.zan.kz/rus/docs/Z950002444> (last access on 03-03-2014)

other operations falls into the category of banking activities. The activities provided by non-banks, on the other hand, do not fall under this definition. Hence, representative services on issues connected to the non-banking activities are not be allowed to be provided by the banks. This might seriously affect the possibility on administering syndicated loan after the transfer to non-banks.

2.3. PARTICIPANTS TO SYNDICATED LENDING ACCORDING TO KAZAKH LAW

The participants of the syndicated deals, just like in the international deals, can be divided as follows (except one of them):

- the Borrower
- the Arranger
- the Agent
- the Creditors

As was mentioned earlier, the banks can benefit from any commercial activity except for those listed in the Law on Banks. Notably, arrangement of credit is neither specified in the list nor could be recognized as a representative service. Therefore, the arrangement of syndicated loan formally should be organized only on the free of charge base.

There is the exact definition of the Agent the legislation in Kazakhstan. According to the Rules on Credit Documentation, “The Agent is the bank to which the members of banking syndicate

entrust representing their interests and providing the credit administration services regarding the syndicated loan during its life”⁵¹.

It is important to note that the foreign currency denomination of the loan might cause additional complications related with the currency control regulation. According to the Article 13 of the Law of the Republic of Kazakhstan “On currency regulation and currency control,” foreign currency transactions between the residents are prohibited, except *inter alia* the following⁵²:

- operations with currency valuables that are considered the banking operations and other operations permitted to the banks and banking organizations;
- payments for the banking services of carrying out the foreign currency transactions, and payments of penalties according to agreements on providing banking services in foreign currency.

Accordingly, in case of loan transfers by the Creditor banks to the non-bank investors, the payments between the borrower and such investors in foreign currency will be very problematic, because such transactions are not considered as banking operations and other operations permitted to the banks and banking organizations.

The Creditors are traditionally banks, like in the international practice. Compared to other investors, they are usually most active players on the stock exchange market. Besides the banks,

⁵¹ *Supra* note 32

⁵² Zakon Respubliki Kazakhstan “O valutnom regulirovanii i valutnom kontrole” (Law on currency regulation and currency control), article 13, available in Russian at http://online.zakon.kz/Document/?doc_id=30013858#sub_id=130000 (last access - 03-03-2014). Other currency control operations listed in that article do not concern with the relationships that might be inside syndicate, therefore they are skipped here.

the Creditors include pension funds, insurance companies and investment funds⁵³. The state investment structures can also act as potential investors – for example, JSC “The Investment Fund of Kazakhstan” or “DAMU Entrepreneurship Development Fund”⁵⁴.

Speaking of the pension funds, it has to be noted that there are two types of them in Kazakhstan – the Single National Pension Fund, which belongs to the state and holds the mandatory pension contributions, and private voluntary pension savings funds, holding the voluntary pension contributions⁵⁵. As of January 1, 2014 the total value of pension savings was 3733.4 billion tenge⁵⁶ (approximately USD 20.5 billion⁵⁷), which could be invested into lending (including syndicated) with low risk ratio and covered by security.

However, neither Single National Pension Fund nor voluntary pension funds are allowed to invest in loans even if they have high level security coverage.⁵⁸ The same prohibitions are imposed on investment possibilities of insurance companies and invest funds⁵⁹.

⁵³ For example please see information notice of National Bank of Republic of Kazakhstan “Current state of stock market of Republic of Kazakhstan” as for 01-01-2014, available in Russian at <http://www.afn.kz/attachments/119/272/publish272-1059353.pdf> (last access on 03-03-2014); or Schedule 2 to the article of Svetlana Gribanova, Tatyana Batysheva, Ob’edinai I vlastvuy (*Unite and Rule*) in journal *Expert Kazakhstan*, N5 (397) dd.04-02-2013, available in Russian at http://expert.ru/kazakhstan/2013/05/ob_edinyai-i-vlastvuy/ (last access on 03-03-2014)

⁵⁴ Mentioned funds belong to the State and their main goals are to stimulate economic development through supporting of business *inter alia* by financing certain projects. More detailed information could be found on their web-sites – “Investment Fund of Kazakhstan” JSC at <http://www.ifk.kz/> and “DAMU Entrepreneurship Development Fund” at <http://www.damu.kz/>

⁵⁵ Zakon Respubliki Kazakhstan “O pensionnom obespechenii v Respublike Kazakhstan” (Law on pension system) available in Russian at http://online.zakon.kz/Document/?doc_id=31408637 (last access on 12-03-2014)

⁵⁶ Analytical notice of National Bank of Republic of Kazakhstan “Current state of saving pension system of Republic of Kazakhstan” as of 01-01-2014, available in Russian at <http://www.afn.kz/attachments/128/271/publish271-1015772.pdf> (last access – 07-03-2014)

⁵⁷ Calculation was made on the basis of exchange rate as USD 1 = KZT 182.02 according to information from the web-site of National Bank of Kazakhstan, available at <http://www.nationalbank.kz/> (last access – 24-03-2014)

⁵⁸ According to the Law on pension system, *supra* note 55, management on pension actives of Single National Pension Fund is conducted by the National Bank of Republic of Kazakhstan. It approves the Investment Declaration. According to temporary Investment Declaration dd. 26-07-2013, available in Russian at <http://www.enpf.kz/download/11191/deklaratsiya%20rus..pdf> (last access on 14-03-2014) there is an exhaustive list of investment instruments amongst which the rights/claims concerned to banking loans are absent. In regarding

So, unlike the international experience, in the Creditors in Kazakhstan are fully cut off from the syndicated lending market. The only remaining investors are banks, state structures and other private investors. However, they are not allowed to invest due to some problems related to the restrictions on the agent-bank side discussed above.

Speaking of the Security trustee concept, it is important to state that while this concept is widely used in the international market, it is not present in Kazakhstan at all to designate a certain trustee for the benefit of different creditors. There is a legislative rule, according to which, if the collateral is pledged to secure another obligation, then claims of the subsequent creditor satisfied after the previous creditor⁶⁰. Even if the agent would act on behalf of each of the banks, it will be still required to determine the priority of their rights in order to consequentially determine the ranking of their claims.

2.4. POSSIBILITY TO IMPLEMENT CONDITIONS ENHANCING EQUALITY BETWEEN CREDITORS IN SYNDICATE ACCORDING TO KAZAKH LAW

In order to preserve a certain balance between the interests of the creditors, the syndicated lending schemes imply use of several instruments as pro-rata sharing, syndicate democracy and perfection of the security interest not on the behalf of each of the creditors, but on the behalf of

to voluntary pension funds the restrictions imposed by the Rules of operation of single saving pension fund and/or voluntary saving pension funds dd. 27-08-2013 N237, available in Russian at <http://adilet.zan.kz/rus/docs/V1300008815> (last access on 14-03-2014). According to that Rules such pension funds are also restricted from participating in banking loans.

⁵⁹ According to the Resolution of the National Bank of Republic of Kazakhstan dd. 24-02-2012 N98 there is also restrictions for insurance companies to participate in banking loans. Resolution available in Russian at <http://adilet.zan.kz/rus/docs/V1200007550> (last access - 03-03-2014). In regards to investments funds the similar restrictions imposed by the Resolution of the National Bank of Republic of Kazakhstan dd. 24-02- 2012 N60 (available in Russian at <http://adilet.zan.kz/rus/docs/V1200007540#z0> (last access on 12-03-2014)) and by the Resolution of Agency of Republic of Kazakhstan on regulating and supervision of financial market and financial organizations dd. 22-08-2008 N129 (available in Russian at <http://adilet.zan.kz/rus/docs/V080005316> (last access on 12-03-2014))

⁶⁰ *Supra* note 34 article 311

the common Security trustee. However, the implementation of these principles in Kazakhstani reality might be problematic.

Speaking of the pro-rata sharing, one should keep in mind the following: the pro-rata sharing implies repaying the debt by one of the creditors to the other creditors within the syndicate by the simultaneous transfer of debts through subrogation. In Kazakhstan, however, the subrogation is provided only for certain circumstances, including subrogation in the insurance relationships.

According to the Article 339 of the Civil Code of the Republic of Kazakhstan, a claim could be transferred to the third party on the basis of a deal (assignment) or legislation⁶¹. Transfer of claim under a loan agreement implies mandatorily conclusion of the assignment agreement. Moreover, if the loan is secured by the pledge which requires a registration, then assignment of pledgee's right should be additionally registered within the relevant registrar⁶². In other words, there is no automatic change of creditor (without need of conclusion of additional documents/agreements). Automatic replacement of creditor takes place only in following cases⁶³:

- in case of the universal succession;
- on the grounds of the court's decision;
- as a result of execution of the obligation by the guarantor, surety or pledger, such that none of them is a borrower;
- in case of subrogation of the creditor's rights to the insurer;
- in other cases stipulated in the legislation.

⁶¹ *Id.*

⁶² *Supra* note 34 article 346

⁶³ *Supra* note 34 article 344

It has to be noted that the other cases do not imply the repayment of the obligation by the third party in accordance with the agreement.

For such cases, when the obligation is implemented by the third party, the legislation provides creation of the regression right in favor of the party that has performed the obligation.⁶⁴ At the same time, regression right does not mean any transfer of the creditor's right, but only provides the right to reimburse the claim according to the performed obligation. The obligation reimbursement is the new separate obligation between the third party and the debtor.

As a consequence, this might negatively affect the position of the creditor who made the pro-rata sharing. In case of the secured loan, sharing creditor is in the risk of losing his security interest. Since the reimbursement obligation is a new separate obligation which is not covered by the security that covers the loan, the sharing creditor might lose the security or became less prioritized creditor in ranking. In order to secure the obligations by the pledge, the parties have to conclude a pledge agreement as it is required by the Article 300 of the Civil Code of the Republic of Kazakhstan⁶⁵. However, the secondary pledge is allowed only in if it's not prohibited by the previous pledges⁶⁶. So, taking into account that such negative pledge conditions happen often, in order to conclude and register properly of the pledge agreement covering the new security interest of sharing creditor, it would be needed to obtain consent of all the existent pledgees (i.e. other creditors within the syndicate). They are not obliged to give their consent, but even if they agree, and the pledge agreement is signed and registered properly, it won't imply the equality between the creditors, because the fulfillment of the security interest would have been made later

⁶⁴ *Supra* note 34 article 289

⁶⁵ *Supra* note 34 article 300

⁶⁶ *Supra* note 34 article 311

than others'. Thus, the sharing creditor bears the risk to become below the others in the ranking, or even lose the security in case of not getting the consent from the others to secondary pledge.

In additions, since the regression rights to claim reimbursement are not a loan in nature, the bank will not be in a position to accrue the interest on it, except the legally defined fines.

As for the availability of the security trustee mechanisms and implementation of syndicate democracy it was stated above that they also have some complications in usage within the modern legal system of Kazakhstan, which reduces the willingness to be involved in such deals within the country.

2.5. TYPES OF FACILITIES AVAILABLE ACCORDING TO KAZAKH LAW

There are no restrictions regarding the types of facilities in Kazakhstani legislation, except for the list of activities that are allowed to be conducted by the banks. However, it is necessary to say that granting the loans (including overdrafts), issuance of guarantees/ suretyships, letters of credit are included to that list⁶⁷. So, if the bank has the relevant license it might be involved in such operations.

Taking into account that legislation provides the possibility to conclude mixed agreements with the different conditions⁶⁸, the banks are allowed to specify agreement conditions for granting of several credit instruments within the syndicated loan, using both revolving or non-revolving facility conditions. Mixed facility becomes very well spread in banking practice of Kazakhstan⁶⁹.

⁶⁷ Law on banks in Republic of Kazakhstan, *supra* note 40 article 30

⁶⁸ According to article 381, *supra* note 34

⁶⁹ For example please see loan terms and conditions of "ATFBank" JSC available in Russian, Kazakh and English at http://atfbank.kz/images/stories/korp/corp_loan_conditions_rus_kaz_eng04.2013.pdf, and crediting conditions of "HSBC Bank Kazakhstan" at <http://www.kz.hsbc.com/1/2/en/business/commercial-and-global-banking/financing-solutions?langToggle=langToggle&lang=en> (last access – 18-03-2014)

The main credit instruments used in Kazakhstan are loans (including overdraft), bank guarantees and letters of credit. At the same time, it has to be noted that standby letters are not used in our country, because they are considered guarantees according to the Kazakh law.

Guarantees and letters of credit issued by the banks are contingent liabilities of banks. It means that before the execution of such guarantee or letter of credit by the bank, the borrower is not obliged to reimburse any amounts to the bank. Therefore, there is the risk that the issuing bank would bear greater risk in comparison with the others within the syndicate because it will be independently liable before the beneficiary whether the other creditors participated in sharing the risk or not.

Besides that, there are some risks of default of the borrower and enforcement of the security. According to the Article 319 of the Civil Code of the Republic of Kazakhstan, if the proceeds from the enforcement of security exceed the amount of claim, then the difference should be returned to the pledger⁷⁰. But if the contingent liabilities haven't become real, the bank cannot include it into the claim and covers them from the proceeds. The contingent liabilities of the bank, therefore, might become unsecured.

2.6. POSSIBILITY TO IMPLEMENT COVENANTS IN SYNDICATED LENDING ACCORDING TO KAZAKH LAW

There is no legal definition of covenants in the Kazakhstani legislation, except specifying them as some sort of self-restrictions imposed by the issuers of the non-state bonds. So, according to the “Rules on the State Registration of Issuance of Non-State Bonds and on Examination of Reports

⁷⁰ *Supra* note 34 article 319

on Placement and Retirement of the Bonds, on Annulment of Issuance of the Bonds⁷¹”, the bond prospectus has to stipulate the “restrictions (covenants) established by the issuer and not provided in the Law [on securities market] ⁷².”

However, it does not mean that the covenants exist only in the form of restrictions. Kazakhstani legislation allows imposing certain obligations contractually. Thus, for example, the parties can state the obligation on providing certain documents, performing certain acts by the agreement. According to the classification of covenants as they are understood in the international experience, such obligations would also fall under the notion of covenants, as mentioned in the previous chapter.

Banks are also widely use covenants when granting the credits. Although they are not always called so, they are present in the loan agreements. For instance, in among the General loan terms and conditions for legal entities/private entrepreneurs⁷³ of JSC “ATFBank”, there are obligations to provide certain documentation and information, to act in compliance with the legislation, and other obligations. Additionally, there are certain circumstances in occurrence of which the bank will be allowed to claim early repayment. For example, granting loans to the third parties, disposal or pledge of property, change of shareholders, dividend payment can be construed as the events that allow the bank to call for acceleration of the loan.

Therefore, it can be inferred that Kazakhstani practice allows use of all three types of covenants – financial, affirmative and negative, if the parties agreed on them contractually. However, the

⁷¹ Pravila gosudarstvennoy registratsii vypuska negosudarstvennykh obligatsiy i rassmotreniya otchetov ob itogakh razmesheniya i pogasheniya obligatsiy, annulirovaniya vypuska obligatsiy (Rules on state registration of issuance of non-state bonds and on examination of reports on placement and retirement of bonds, on annulment of issuance of bonds) available in Russian at <http://adilet.zan.kz/rus/docs/V050003822>

⁷² *Id.* section 40-1

⁷³ *Supra* note 69

negative covenants are implemented in practice with some caution. There are some differences in opinions of the practicing lawyers regarding the contractual rejection of certain rights guaranteed by the law. For example, waiver made by the borrower of the right to freely dispose his property (not pledged property) may be considered as an invalid condition, because, by the law, everybody is guaranteed to enjoy his right to freely dispose his property, unless it is restricted by the law. According to that ambiguity some banks stipulate negative covenants not as some restrictions, but rather as circumstances to trigger the bank's right to accelerate of the outstanding amount.

It is also important to note that the breach of covenants doesn't result in invalidity of the deals. According to the Article 159 of the Civil Code of the Republic of Kazakhstan, breach of covenants does not falls under the grounds of invalidity of the deals concluded with third parties⁷⁴. Therefore, if the borrower sells or pledges the property contrary to the covenant condition, such deal would not be considered invalid according to the law.

2.7. SECURITY AND SUBORDINATION IN SYNDICATED LENDING ACCORDING TO KAZAKH LAW

According to the article 292 of the Civil Code of the Republic of Kazakhstan, performance of obligation might be secured by penalty, pledge, retention of debtor's property, suretyship, guarantee, earnest money, guarantee fee and by other means specified in the legislation or contract⁷⁵. However, in banking practice pledge and guarantee are widely-used.

⁷⁴ *Supra* note 34 article 159

⁷⁵ *Supra* note 34 article 292

The pledge is divided into two types – hypothec and possessory pledge. Hypothec is the pledge whereby the pledged property remains in the possession and use of the borrower or the third party. Possessory pledge, on the contrary, implies a conferment of the property to the pledgee⁷⁶.

Similar to the collateral, any property or property right (claims), except for the things excluded from turnover, claims inseparably linked to the creditor's personality, and other rights, transfer of which is prohibited by the Law, can be considered as a pledge⁷⁷.

The pledge of immovable property must be registered, and the security interest is recognized as occurred only after the registration⁷⁸. The security interest of a subsequent creditor generally ranked lower than of a previous pledgee⁷⁹. Therefore, the security interest registered later is ranked lower than the previous one.

Unlike immovable property, the pledge of a movable property is subject to a mandatory registration only if the movable itself requires a registration. For example, cars, railway carriages, planes have to be registered. Therefore, the pledge of such property also should be registered. Certain types of movable property do not fall under the requirement for registration, thus, there is no obligation to register the pledge of such property.

Frequently the pledgees insist on registration of the pledge agreement of any kind of property.

The rationale is that ranking of the creditors depends on registration sequence. Each preceded

⁷⁶ *Supra* note 34 article 303

⁷⁷ *Supra* note 34 article 301

⁷⁸ Zakon Respubliki Kazakhstan "O gosudarstvennoi registratsii prav na nedvizhimoye imushchestvo" dd.26-07-2007 N310-III (Law on registration of rights on immovable property), article 5, available in Russian at <http://adilet.zan.kz/rus/docs/Z070000310> (last access on 08-03-2014)

⁷⁹ *Supra* note 34 article 311

registered pledgee has a priority against all the subsequent registered pledgees as well as all the unregistered pledgees⁸⁰.

As stated earlier, there is no Security trustee in Kazakhstan, therefore, the registration is carried out in the name of the pledgee. Depending on the registration sequence the rights are considered respectively in case of enforcement of the security in order to satisfy the claims. Besides that, the switch of the pledgee requires the change of the relevant data in the registrar⁸¹. Thus, further transfer of the loan requires registration of these changes in the registrar.

In case of default, the enforcement of the security can be done either through the court or using an out-of-court settlement procedure⁸². Court enforcement procedure implies public auction arranged by the Officer of Justice. On the contrary, the out-of-court settlement implies public auction arranged by the authorized agent of the pledgee. The legislation does not define the out-of-court settlement procedure in case of several pledgees and does not impose any restrictions on this method of enforcement. In both cases proceeds gained out of a sale are distributed between the creditors in accordance with their rankings. Thus, pledgees registered later get their portion only after preceded pledgees. If the proceeds are not enough, then it is possible to recover the debts from the other property of the borrower by bringing the action in court. However, in the out-of-court procedure it is impossible to recover from the other property of the borrower in case of deficiency, if the collateral is an immovable property. According to the article 37 of the Law of

⁸⁰ Zakon Respubliki Kazakhstan "O registratsii zaloga dvizhimogo imushchestva" dd.30-06-1998 N254-I (Law on registration of movable property pledge) available in Russian at <http://adilet.zan.kz/rus/docs/Z980000254>

⁸¹ According to Law on registration of rights on immovable property, *supra* note 78, article 6 and Zakon Respubliki Kazakhstan "Ob ipoteke nedvizhimogo imushchestva" dd.23-12-1995 N2723 (Law on hypothec of immovable property) available in Russian at <http://adilet.zan.kz/rus/docs/U950002723> article 9 in respect of immovable property and article 16 of Law on registration of movable property pledge, *id.*, in respect of movable property

⁸² *Supra* note 34 article 318

the Republic of Kazakhstan “On hypothec of immovable property”, in case of the out-of-court enforcement of collateral that entirely covers the obligation at the moment of conclusion of the pledge agreement, the termination of the pledge simultaneously discharges obligations on the loan⁸³. So the residual amount of the debt that is not covered from the proceeds is written off automatically. Thus, those creditors whose debts are not covered by proceeds from the sale might lose their money. Even though the syndicated loan agreement might include the pro-rata sharing principle, it doesn't provide a satisfying result, since the pro-rata sharing implies subrogation or regression, i.e. a fulfillment of an existing debt. But in the case of the write-off, the debt is ceased to exist and, therefore, any obligation to pay the debt is cancelled as well.

The guarantee and suretyship differ from each other by the nature of liabilities. The guarantee implies joint and several liabilities, whereas the suretyship implies only a secondary liability⁸⁴, meaning that the guarantee can be called immediately after a non-fulfillment of the obligations by the borrower. Unlike the guarantee, in the suretyship the surety is called to cover the debt only after reasonable actions to recover the debt from the borrower has been taken⁸⁵. Thus, due to the higher burdensome, the suretyship is used infrequently compared to the guarantee.

Regarding subordination in Kazakhstan, it is possible to implement only a turnover subordination with the condition to create an indebtedness of the junior creditor towards the senior after receiving payments from the debtor. In fact, this agreement between the creditors is considered a “promise of gift”, because after the completion of the accounts settlement in bankruptcy proceeding, the debtor is released from all the remaining debts, i.e. obligations are terminated⁸⁶.

⁸³ Law on hypothec of immovable property, *supra* note 81 article 37

⁸⁴ *Supra* note 34 articles 329 and 330

⁸⁵ *Supra* note 34 article 332

⁸⁶ Zakon Respubliki Kazakhstan “O reabilitatsii i bankrotstve” (Law on rehabilitation and bankruptcy) article 109 dd.07-03-14 available in Russian at <http://adilet.zan.kz/rus/docs/Z1400000176> (last access - 10-03-2014)

Therefore, a payment from the junior creditor to the senior creditor is not a fulfillment of the obligations of the debtor, but rather a separate independent gratuitous transfer of money on the basis of contractual promise. However, at the same time in accordance with the article 506 of the Civil Code of the Republic of Kazakhstan, a promise to grant gratuitously the entire property or a part of the property without a concrete definition of it, the right or release from the obligation is considered invalid⁸⁷. Thus, certain disputes related to the validity of the agreement might arise if an amount of money that is transferable in the future is not exactly specified in the agreement.

The turnover subordination using the scheme of trust method, however, is not workable in Kazakhstan due to the absence of required legal relationship in its legal system. Contractual subordination is not supported by the law as well, since a contractual change of a strict ranking of the creditors established earlier is impossible.

2.8. LOAN TRANSFER AND PARTICIPATION ACCORDING TO KAZAKH LAW

The Kazakhstani legislation allows a transfer of claims to the third party. According to the Article 339 of the Civil Code of the Republic of Kazakhstan, the right (claim) can be transferred to the third party on the basis of a deal or a law⁸⁸. The debtor consent is not required unless stated directly by the law or the contract. According to the article 341 of the Civil Code of the Republic of Kazakhstan, unless otherwise specified by the law or contract, the right is transferred to the same extent and under the same conditions that existed prior to the transfer, including security, rights on unpaid interest and others⁸⁹. In order to transfer the rights according to the written agreement it is needed to sign the relevant written assignment agreement. At the same time, in order to effectuate the transfer of the security interest to the collateral it is also needed to

⁸⁷ *Supra* note 41 article 506

⁸⁸ *Supra* note 34 article 339

⁸⁹ *Supra* note 34 article 341

conclude written assignment agreement for pledge and its registration (if the pledge agreement has to be registered)⁹⁰.

Transfer might be either for fee or free of charge, there are no prohibitions in the legislation. There are also no restrictions on separation of rights and obligations – so the creditor can transfer his rights or claims, but retain his obligations on it. In the Kazakhstani practice, however, the transfer of rights is usually accompanied with the transfer of obligations, i.e. full change of party occurs.

Novation in the Kazakhstani legislation differs from what was described in the previous chapter. According to the Article 372 of the Civil Code of the Republic of Kazakhstan, novation is the alteration of one obligation by the other between the same parties, but it doesn't imply change of the parties⁹¹.

So as it might be inferred, the transfer of rights/claims and obligations is possible, but there might be some problems related to subsequent relationships with the agent bank in case of the transfer to non-banking companies, as it was described earlier.

As for the sub-participation schemes, it must be stated that they can be implemented in Kazakhstan, but they are subject to certain risks. According to the funded participation scheme there should be a deposit from the investor. Article 757 of the Civil Code of Kazakhstan lists three types of deposit – call deposit, term deposit, and conditional deposit. Call deposit has to be returned on the first demand, term deposit is returned on the expiration of the term, and the conditional one should be returned on the occurrence of the condition⁹². It's obvious that funded

⁹⁰ *Supra* note 34 article 346

⁹¹ *Supra* note 34 article 372

⁹² *Supra* note 41 article 757

participation requires use of either term or conditional deposit. But in accordance with the Article 765 of the Civil Code of Kazakhstan the bank is obliged to return the money on the first demand even if the term is not expired or condition is not occurred⁹³. So for the “transferring” bank it might be disadvantageous to enter in such deals, since it cannot transfer its own obligations toward the investor, or the obligations of the borrower toward itself.

Additionally funded participation implies paying a fee to a participant for assumption of double risk for both borrower and the bank. However, if the participant is the bank, it cannot receive such fee, because assumption of the risk is not covered by the legislation on banks, unless it is not a factoring, and in the case of factoring there is an assignment of the rights, which is doesn't apply in this situation.

As for an unfunded participation, it is possible to be implemented. The nature of that scheme is issuance of the guarantee by the participant. So if the participant is the bank, it can face some regulatory obligations. According to the Section 23 of the Rules on Credit Documentation, the bank guarantees that it should collect a credit dossier analogous to the one for loans with all information and documentation from the debtor⁹⁴. It also has to carry out a monitoring of the debtor, according to the Section 27 of the Rules. So, in case of unfunded participation by the bank, it would obliged to bear the same obligations and costs for regulatory purposes as for granting the loans.

⁹³ *Supra* note 41 article 765

⁹⁴ *Supra* note 31

CONCLUSION

Summarizing the abovementioned risks and problems that could arise in Kazakhstan in regarding to syndicated lending, one can be convinced that although it is theoretically possible, but it is practically disadvantageous to be involved in such schemes there. By entering into such transactions the creditor would not fully achieve real risk sharing, which is main purpose, but rather would get additional risks, for example stemmed from consortium nature of such transaction.

Therefore it is crucial to understand how problems should be solved in order to attract creditors to use this tool. Otherwise I think syndicated lending would still be as a mere theoretical instrument with absolutely useless practical meaning.

On the basis of abovementioned analysis I will elaborate the problems with providing certain recommendations for their resolving.

Consortium nature problem

As it was stated before, according to Kazakhstani legislation it is very likely that syndicate would be considered as a consortium (joint unincorporated entity), thereby applying certain negative impacts on creditors. Moreover, it couldn't be resolved via contractual conditions between the parties. Therefore it could be strong reason for the parties to abstain from syndicated lending.

In United Kingdom, for example, syndicate is not recognized as a partnership (the form of unincorporated entity) "because there is no sharing of net profit between the members of the

syndicate”⁹⁵, as well as in U.S.⁹⁶, although syndicate members still have common purpose and sign a common agreement.

Taking into account that it is not possible to contractually avoid application of consortium nature of syndicate in Kazakhstan, it is necessary to make relevant amendments into the legislation precisely stipulating that syndicate of banks in syndicated lending transactions are not a consortium.

Pro-rata sharing problems

As it was stated above in Kazakhstan there is no subrogation of the rights (debts) to sharing creditor from the creditor that received its portion according to pro-rata sharing clause. It could lead to the problem with ranking and even loss of security interest. At the same time Kazakhstani legislation provide for automatic transfer of creditor’s right in case of execution of the guarantee by the guarantor. So in my opinion this approach could be extended to situations of paying the borrower’s debts by the third parties, because functionally it is almost the same, except that the obligation of that third party is not joint and several as in case of guarantee.

Therefore it is needed to add into the Civil codex the provisions that would prescribe automatic transfer of creditor’s rights to the third party which paid the obligations of the debtor, unless otherwise is not agreed by the parties.

Security trustee problem

Existence of security trustee makes it possible not only to hold the creditors on the same level towards the security, but also to make the transfer of loan easier. Since there is no need to register

⁹⁵ E.P. Ellinger, Eva Lomnicka, Richard Hooley, *Ellinger’s Modern Banking Law* 719 (4th ed., 2006)

⁹⁶ Arthur R. Pinto, Douglas M. Branson, *Understanding Corporate Law* 5 (1999)

the change of security holder, because the Security trustee holds security interest on behalf of all the creditors, transfer requires only providing relevant information to Security trustee.

Taking into account the problems with the ranking of security interest of several creditors in Kazakhstan, possibility to designate one representative on the name of whom security interest is registered on behalf of all creditors, would be a solution to mitigate the risks. Therefore it is recommended to make necessary alterations in legislation which would allow to implement security trustee scheme.

Prohibition to enter into the market for institutional investors problem

In order to boost loan market as a whole and especially syndicated lending market it is needed to allow more investors to be get involved with it. It is obvious, that it should be also assessed how risky it might be for them in comparison with conventional investment tools, but in my view at least secured loans might allowed to investment.

As it is shown in this paper, the most active institutional investors are barred from the loan market in our country. However, according to international experience they participate in such transactions⁹⁷.

I think it might be possible to reassess the risks and try to allow to some extent to pension funds, insurance companies and investment funds in Kazakhstan participate in loan market by investing in high level loans. For that purposes the list of permitted instruments for investment might be added by such loans. It might not only diversify their portfolio, but also might boost crediting as a whole.

⁹⁷ For example please see Steve Miller, *Players in the Market in The Handbook of Loan Syndications and Trading* 47, 51 (Allison Taylor, Alicia Sansone eds., 2007)

Restriction to act as an agent for non-banking organizations

The other problem connected to the investors is that banks in Kazakhstan are restricted to act as a representative on issues not related to banking operations. It creates some ambiguity and even risk for agent bank when the transfer of loan occurs in favor of non-banking organization.

So in order to eliminate possible misunderstanding or even penalties from the regulatory body, it should be clearly stated in the legislation, that agency functions of the banks in syndicated lending is allowed independently on what types of investors participate in loan.

Currency control problems

Although currency control issues could be resolved by the agreement throughout special clauses provided for converting payments into the local currency, it might for somehow decrease participants' desire to be involved in such transactions.

At the same time as it might be inferred the legislator exempt banking operations from the currency control restrictions in order to make it possible to foreign currency loans exist in Kazakhstani market. Therefore I think it will coincide with the rationale of that permission for the banks also to administer foreign currency loans even after transfer of rights to non-banking organizations. In that sense it is needed to exempt from restricted operations also loans in foreign currency provided by the banks and transferred to third parties.

Bureaucracy problems

There are some mandatory rules mentioned earlier regarding the form and content of the loan agreement in Kazakhstan. However, it seems more efficiently if the content and technical issues as size and number of pages for instance would not be prescribed by legislation for bank loans to corporate customers. Such customers are presumed to be sophisticated in business transactions,

or at least they have possibilities to hire a legal firms for support. So in my view it would be better to exempt from the form and content requirements loans to corporate customers. However it is not crucial for implementing syndicated lending schemes in Kazakhstan, because it is still possible to follow this rules in such type of financing.

Additionally the requirement to have a full credit dossier by each of the member of syndicate also may be too burdensome for the borrower. Therefore may be it would be better to leave such requirement only to agent bank and allow to hold to other banks some sort of “light” dossier with only necessary documents for monitoring purposes.

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