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Governance through Financial Regulation: Administrative Regulations, Compliance Mechanisms, and De Facto Implementation Dynamics in the Kazakhstani Banking Sector

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Abstract

This study aims to examine the functionality of financial regulations as a governance instrument in the Kazakhstani banking sector and the effectiveness of these regulations at the level of actual implementation. Over the past decade, Kazakhstan has undertaken comprehensive reforms to align its banking system with international standards (Basel III) and to establish the confidence of foreign investors through the Astana International Financial Centre (AIFC). However, a certain degree of distance, commonly referred to as an implementation gap, appears to exist between administrative regulations on paper and actual implementation dynamics within the sector. The article analyses the role of the Agency for Regulation and Development of the Financial Market of Kazakhstan (ARDFM), banks' internal compliance mechanisms, and structural issues such as related-party transactions. Based on qualitative research methods and secondary data analysis, the study demonstrates that financial governance is not merely a legal obligation but also a strategic element of institutional sustainability. The findings indicate that regulatory independence and transparent supervisory mechanisms are critically important for ensuring the long-term sustainability of financial stability in Kazakhstan.

Keywords: Kazakhstani Banking Sector, Financial Governance, Administrative Regulation, Compliance Mechanisms, ARDFM.
Jel codes: G21, G28

1. Introduction

Crises in the global financial system and technological transformations have made it necessary for the banking sector to function not merely as an economic actor but also as a domain of governance subject to strict supervision. Governance through financial regulation is regarded as one of the most tangible indicators of a country's capacity to preserve economic stability. Gleeson (2018) emphasises that the fundamental principles of financial regulation are concerned not only with correcting market failures but also with establishing systemic confidence. In this context, Kazakhstan has been undergoing a comprehensive institutional transformation in its banking sector since independence, with the ambition of becoming the largest financial centre in Central Asia.

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The Kazakhstani banking system entered a new phase through the establishment of the Agency for Regulation and Development of the Financial Market (ARDFM), which was intended to address structural problems that emerged particularly after the 2008 financial crisis. According to the report published by the Agency for Regulation and Development of the Financial Market (2024), Kazakhstan's banking sector has maintained its resilience through high capital adequacy ratios. Nevertheless, the agency's supervisory findings highlight areas that still require improvement, particularly in risk management processes. The fact that administrative regulations are formally aligned with international standards does not necessarily translate into equivalent effectiveness in practice. Indeed, the results of the Asset Quality Review (AQR) published by the Agency for Regulation and Development of the Financial Market (2024) emphasised the need to integrate banks' credit risk models and collateral valuation processes more closely with international best practices (p. 14).

The central research problem of this article concerns the dynamics encountered during the implementation of the advanced compliance mechanisms established in the Kazakhstani banking sector. The study aims to analyse how governance principles are constructed through financial regulations and to identify the structural obstacles facing compliance processes in the sector. Accordingly, the article first examines the theoretical framework of financial governance, then analyses Kazakhstan's existing regulatory structure, and subsequently focuses on the risks associated with actual implementation processes.

2. Theoretical Framework

Governance in financial systems concerns how institutions are managed and supervised and how accountability mechanisms are designed. In the banking sector, governance is not merely an internal management issue; rather, it constitutes a multilayered structure shaped by the interventions of external regulatory institutions.

2.1. The Concept of Regulatory Governance

Regulatory governance refers to the set of standards, processes, and institutions employed by public authorities to supervise financial markets. The concept focuses on the independence, transparency, and accountability of regulators. Llewellyn (2021) argues that effective financial regulation depends not only on establishing rules but also on how those rules are combined with market discipline. In emerging markets such as Kazakhstan, regulatory governance also serves as an anchor for building confidence among market participants and minimising systemic risks.

2.2. Agency Theory and Financial Compliance

Agency Theory underpins administrative regulations in the banking sector. According to this theory, conflicts of interest and information asymmetries exist between bank owners and managers (agents), on the one hand, and depositors and the public (principals), on the other. Within the framework theorised by Jensen and Meckling (1976, as cited in Yıldız, 2022), managers may make risky decisions in pursuit of their own interests. Financial regulations and compliance mechanisms are designed as supervisory instruments to reduce information asymmetry and ensure that agents act in accordance with the interests of principals.

2.3. The Relationship between Compliance Mechanisms and Corporate Governance

Compliance mechanisms are systems that monitor the extent to which banks adhere to both domestic legislation and international standards, such as Basel III. In the corporate governance literature, compliance is understood not merely as a legal obligation but also as an ethical commitment and a component of reputation management. The corporate governance principles published by the OECD (2023) envisage the development of risk-based compliance strategies by boards of directors and the periodic review of these processes by independent auditors. In Kazakhstan, the ARDFM likewise requires banks to modernise their internal control systems in accordance with these global principles.

The prominent role of the state in the Kazakhstani banking sector directly affects governance dynamics. La Porta et al. (2002) argue that state ownership of banks may constrain financial development and efficiency, and that these limitations can be addressed only through rigorous and transparent supervision.

3. The Regulatory Structure of the Kazakhstani Banking Sector

The governance of Kazakhstan's financial system has undergone continuous evolution since the country's transition to a market economy. The administrative dimension of financial regulation encompasses not only the formulation of legal texts but also the establishment of the institutional architecture required to implement them. This section analyses the institutional structures and respective powers of the principal authorities supervising Kazakhstan's banking sector, as well as the process of integrating Basel III standards into domestic legislation. Understanding governance dynamics within the sector requires an examination of the historical transformation of regulatory institutions and the instruments through which they intervene.

3.1. The Evolution of Regulatory Institutions: The NBK and the ARDFM

Since 2020, financial regulatory responsibilities in Kazakhstan have been divided between two principal institutions. While the National Bank of Kazakhstan primarily focuses on monetary policy and price stability, the Agency for Regulation and Development of the Financial Market (2024) is responsible for the direct supervision of the banking sector and the protection of consumer rights. Although this institutional separation has facilitated greater specialisation in supervisory processes, its implications for governance dynamics, particularly in terms of coordination between the two institutions, remain a subject of discussion. The data shared by the two institutions and their joint supervisory mechanisms are especially important for managing systemic risks and represent key determinants of the effectiveness of implementation in practice.

3.2. The Process of Compliance with Basel III Standards

Kazakhstan has been implementing Basel III standards incrementally to modernise its banking system and facilitate integration into global financial markets. The guidelines published by the Agency for Regulation and Development of the Financial Market (2023) indicate that capital adequacy ratios (CAR) and liquidity coverage ratios (LCR) have been tightened. However, the extent to which these administrative regulations are reflected in actual practice varies, particularly when the capital structures of medium-sized banks are examined. While the high compliance costs associated with Basel III place pressure on banks' profitability, they also necessitate a more transparent reporting framework under Pillar 3.

3.3. The Role of the Astana International Financial Centre (AIFC) in the Governance Architecture

The evolution of financial governance in the Kazakhstani banking sector necessitates separate consideration of the Astana International Financial Centre (AIFC), which became fully operational in 2018. The AIFC forms part of Kazakhstan's strategy not only to become a regional financial centre but also to improve the overall quality of governance within the country.

4. Methodology

Examining the impact of financial regulation on governance requires a multidimensional approach that encompasses both the analysis of legal texts and the assessment of their practical implications in the market. This section discusses the methodological framework of the study, data collection techniques, and the limitations of the analysis. The selected methodology enables a comparison between theoretical assumptions and practical realities, thereby helping to identify the implementation dynamics of administrative regulations in the Kazakhstani banking sector.

4.1. Research Method and Scope

This study employs descriptive regulatory analysis and case study methods, both of which fall within the broader framework of qualitative research. The research examines reports published by the Agency for Regulation and Development of the Financial Market (ARDFM) for the period 2020–2024, Basel III compliance guidelines, and the annual reports of selected commercial banks. As emphasised by Yıldırım and Şimşek (2021), document analysis is a critical tool for understanding the historical and administrative development of phenomena in institutional settings that require in-depth examination.

4.2. Data Sources and Limitations

The dataset comprises official statistics published by the ARDFM, International Monetary Fund (IMF) country reports on Kazakhstan, and the World Bank's financial governance indicators. The principal limitation of the study is that, owing to confidentiality surrounding related-party transactions and ownership structures at certain Kazakhstani banks, actual implementation dynamics can be analysed only through publicly available reports and supervisory findings, including Asset Quality Reviews (AQR).

5. Findings and Discussion

The effectiveness of financial governance in the Kazakhstani banking sector depends on the balance between the technical quality of administrative regulations (*de jure*) and their practical application (*de facto*). This section discusses the findings derived from ARDFM reports and banking data, supported by a comparative assessment of governance and compliance practices across the sector.

5.1. Implementation Gap Analysis

Although administrative regulations aim to standardise banks' risk management processes, ownership structures and local market dynamics continue to shape their practical implementation. The following table presents a comparison summarising the principal findings of the study.

Table 1. Comparative Assessment of Governance and Compliance in the Kazakhstani Banking Sector

Area of Analysis	**Administrative Regulation (*De Jure*)**	**Actual Implementation (*De Facto*)**	**Identified Gap**
Risk Management	Requirement to use Basel III-compliant expected credit loss (ECL) models.	Optimistic collateral valuations in banks' internal models.	High: Tendency to understate risks on paper.
Related-Party Transactions	Credit exposure limit set at 10% of equity.	Indirect credit flows channelled through complex holding structures.	Moderate: Circumvention of regulatory requirements.
Independent Supervision	Requirement for independent members on boards of directors.	Symbolic presence of independent members and lack of effective veto powers.	High: Ownership-related pressure on decision-making processes.
Transparency	Detailed public disclosure under Pillar 3.	Extensive disclosure of technical data but limited disclosure of risk-related details.	Low: Reporting is quantitatively adequate but qualitatively weak.

Source: Compiled by the author from reports published by the Agency for Regulation and Development of the Financial Market (2024) and the IMF (2023).

5.2. Theoretical and Empirical Discussion of the Findings

The data presented in Table 1 indicate that formal compliance in the Kazakhstani banking system is relatively advanced, whereas substantive governance remains at a developmental stage. The results of the Asset Quality Review (AQR) conducted by the Agency for Regulation and Development of the Financial Market (2024) demonstrate that banks tend to present a more optimistic assessment of credit risk classification than that reflected in the regulator's assessments (p. 44). Within the framework of Agency Theory, this situation reflects the information asymmetry between the principal (the regulator) and the agent (bank management).

As stated in the IMF's (2023) country report on Kazakhstan, the supervision of banks' risk models should not be reduced to a procedural exercise involving the completion of administrative forms. The findings of this study indicate that practices involving the circumvention of regulations continue to be a concern, particularly in relation to related-party transactions. Accordingly, the practical effectiveness of administrative regulations requires the ARDFM to possess not only rule-making authority but also the supervisory capacity to examine banks' business models and ownership structures in depth.

5.3. Digitalisation and the Future of Compliance

The findings also suggest that digitalisation reduces compliance costs while creating challenges related to the speed of supervision. Kazakhstan's leadership in fintech makes the digitalisation of governance through regulatory technology (RegTech) increasingly necessary. However, in practice, medium-sized banks with weaker technological infrastructures may experience losses in operational efficiency while attempting to comply with administrative regulations. This situation indicates that the principle of regulatory proportionality, emphasised by Llewellyn (2021), warrants further examination in the specific context of Kazakhstan.

5.4. Case Studies: Governance Failures and Bank Failures

One of the most effective ways to assess the practical effectiveness of administrative regulations is to examine past banking crises and the governance failures underlying them. The crises experienced between 2017 and 2021 revealed situations in which regulations formally existed but failed to operate effectively in practice. As Demirgüç-Kunt and Detragiache (2011) note, banking crises in developing countries frequently arise from weak institutional frameworks and inadequate supervision. The cases observed in Kazakhstan are consistent with these theoretical findings. In this respect, case studies drawn from the history of Kazakhstan's banking sector illustrate why regulatory governance must extend beyond formal rules and documentation.

5.4.1. The Bank RBK Case: Related-Party Transactions and the Liquidity Crisis

The Bank RBK crisis, which emerged in 2017, demonstrated the extent to which related-party lending could become a source of risk in the Kazakhstani banking sector. A substantial proportion of the bank's loan portfolio was found to have been channelled into projects associated with the bank's shareholders.

- Regulatory Failure: Although compliance with Basel III standards was reported formally, credit risks were allegedly concealed in practice through off-balance-sheet arrangements.
- Governance Implications: This case illustrates why supervisory authorities, including the Agency for Regulation and Development of the Financial Market (ARDFM), must examine not only banks' capital adequacy but also the actual influence of ownership structures on credit decisions. The crisis resulted in a state rescue operation exceeding KZT 240 billion, creating a substantial fiscal burden.

5.4.2. Delta Bank and Qazaq Banki: Supervisory Weaknesses and Licence Revocations

The revocation of Delta Bank's licence in 2018 and the subsequent revocation of Qazaq Banki's licence intensified debates about regulatory capture in Kazakhstan's banking system. A common problem in both cases was the concealment of poor-quality assets in reported financial information.

- Findings: According to information attributed to the Agency for Regulation and Development of the Financial Market (2024), no critical warnings were reportedly evident in these banks' compliance reports even shortly before their failures. This situation suggests that administrative regulations remained focused on documentation and failed to reflect actual risks in practice.
- Agency Theory Perspective: These cases provide concrete examples of how bank managers, acting as agents, may manipulate supervisory mechanisms while making high-risk decisions that disadvantage the principals, namely depositors and the public.

5.4.3. The Kazkommertsbank (KKB) and Halyk Bank Merger: The "Too Big to Fail" Problem

The difficulties experienced by Kazkommertsbank, one of Kazakhstan's largest banks, and its subsequent acquisition by Halyk Bank represent a turning point in systemic risk management.

Governance Dynamics: The perception that KKB was too big to fail encouraged a more interventionist approach by the regulator, the National Bank of Kazakhstan (NBK), rather than an exclusively rules-based supervisory approach. Assessments published by the International Monetary Fund (2023) indicate that such consolidation processes may reduce market competition and complicate governance transparency.

5.5. Financial Technologies (FinTech) and Regulatory Technology (RegTech): A New Dimension of Governance

Kazakhstan occupies a leading position in the digitalisation of banking services across Central Asia and the wider Eurasian region. However, this digital transformation has made the evolution of administrative regulations and governance mechanisms increasingly necessary. Regulatory technology (RegTech) has emerged as a potential instrument for improving the effectiveness of administrative regulations during their practical implementation.

5.5.1. Kaspi.kz and Platform Banking

The example of Kaspi.kz, one of Kazakhstan's largest digital ecosystems, has created governance requirements that extend beyond the scope of traditional banking regulation. The Agency for Regulation and Development of the Financial Market (2024) acknowledges that financial services delivered through digital platforms cannot always be fully assessed using conventional credit risk models. This situation brings the concept of algorithmic governance to the forefront.

Zetzsche et al. (2017) argue that, during the transition from FinTech to TechFin, the fundamental dilemma facing regulators is how to control risks without stifling innovation. In Kazakhstan, the speed and user experience offered by Kaspi.kz may cause supervisory mechanisms to lag behind technological developments. Consequently, adapting administrative regulations to the pace of digital innovation through RegTech has become increasingly necessary.

5.5.2. Cyber Risk Management and Operational Resilience

Although digitalisation reduces the need for physical branches, it may also expose banks to cyberattacks. Administrative regulations, including Basel III operational risk standards, require banks to strengthen their approach to operational risk management and cybersecurity.

The findings of this study suggest that investment in technological infrastructure may positively influence the quality of corporate governance in Kazakhstani banks. In accordance with the operational resilience principles published by the Basel Committee on Banking Supervision (BCBS, 2020), banks should focus not only on cybersecurity but also on business continuity and data integrity. Nevertheless, the available evidence indicates that cybersecurity awareness in Kazakhstan remains largely reactive, responding to incidents after they occur. Governance mechanisms therefore need to evolve towards a more proactive approach.

6. Conclusion

This study has analysed both the administrative structure and the actual implementation dynamics of governance through financial regulation in the Kazakhstani banking sector. As a cornerstone of Kazakhstan's economy, the banking sector has undergone substantial regulatory modernisation over the past decade. However, the findings demonstrate that the effectiveness of regulations on paper (*de jure*) does not always correspond directly to the quality of governance in practice (*de facto*).

The principal conclusions of the study are as follows:

1. The Gap Between Regulation and Implementation: Although Kazakhstan has made considerable progress in aligning its administrative framework with Basel III standards, the quality of corporate governance in practice varies considerably across banks. In particular, banks appear inclined to present more optimistic risk assessments than those reflected in regulatory evaluations during risk-based supervisory processes.
2. Ownership Structures and Supervisory Effectiveness: Concentrated ownership in the Kazakhstani banking sector is one of the principal factors complicating governance transparency. Although related-party transactions are subject to regulatory limits, complex holding structures may enable these restrictions to be circumvented. This situation reflects the continued presence of agency costs within the financial system.
3. The Dual Impact of Digitalisation: Kazakhstan's leading position in fintech has enabled the digitalisation of compliance processes and improved operational efficiency. However, the failure of supervisory capacity to keep pace with technological developments introduces new challenges, including cyber risks and weaknesses in digital governance.

Recommendations for the Future

- Supervisory Independence: The operational independence of the Agency for Regulation and Development of the Financial Market (ARDFM) should be reinforced through legal safeguards that protect it from political and economic interference.
- Greater Transparency: Beneficial ownership requirements should be enforced rigorously in relation to banks' ownership structures. Public disclosures should move beyond the completion of technical reporting forms and achieve a more substantive level of transparency.
- Regulatory Proportionality: A more effective risk-based and proportionate supervisory approach should be implemented to prevent small and medium-sized banks from being disproportionately burdened by high compliance costs.

In conclusion, transforming financial regulation into a genuine governance achievement in the Kazakhstani banking sector requires more than aligning legal texts with international standards. It requires the development and dissemination of a supervisory culture characterised by transparency, accountability, and independence throughout the sector.

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