

RESTRICTIONS ON RAISING AND GRANTING LOAN FUNDS TO INDIVIDUALS

In 2019, the bank loan portfolio for consumer loans in Kazakhstan amounted to 3.6 trillion KZT. In addition to banks, microfinance and other organizations regulated by the National Bank, there were entities in the lending market whose activities were not regulated by any authorized body. Such entities included online lending companies, credit partnerships, pawnshops and other legal entities that provided loans to the population.

The lack of uniform approaches to lending activities has since led to regulatory arbitration. Regulated entities - banks, organizations engaged in certain types of banking operations and microfinance organizations were obliged to comply with the established legislative prudential requirements (capital adequacy, the amount of risk per borrower, liquidity) and consumer protection requirements (conditions for granting loans, maximum rates of remuneration, commissions, fines). Consequently, they found themselves in an unequal position with unregulated creditors.

Prior to these new restrictions, there were frequent violations of consumer interests by unregulated creditors. For example, creditors took advantage of the low financial literacy of the population, unregulated lenders provided loans to citizens at high rates, with various commissions and fines, which increased the risks of excessive debt burden on citizens and the impossibility of loan obligations fulfilment. The ability to carry out transactions with money and other property in the absence of control and supervision increased the risks of using the services of unregulated creditors for legalization (laundering) of proceeds from crime and financing terrorism.

In order to resolve these problematic issues, the Government adopted the Law «On amendments into some legislative acts of the Republic of Kazakhstan on the regulation and development of the financial market, microfinance activities and taxation" (hereinafter - the "New Law"), dated July 3, 2019 that introduced amendments to the Civil Code of the Republic of Kazakhstan, including restrictions on the ability to provide loans to citizens by legal entities and individual entrepreneurs.

In this publication, we review both the previously existing legislative restrictions on the possibility of raising loan funds from citizens, as well as the newly introduced restrictions on the provision of loans to citizens.

- **Prohibition on issuing loans to citizens**

The New Law supplemented Article 715 of the Civil Code of the Republic of Kazakhstan with clause 2-1, which prohibits individual entrepreneurs and legal entities from providing money in the form of a loan to citizens and such agreements are null and void. This law has been in effect since July 1, 2020 in the Republic of Kazakhstan.

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There are, however, notable exceptions to this restriction. The prohibition does not apply to:

- 1) provision of a loan in the form of an advance payment, prepayment, deferral and payment by instalments for goods (works and services);
- 2) providing money in the form of bank loans and microcredits in accordance with the laws of the Republic of Kazakhstan;
- 3) a loan by the employer to its employee, a retiree who previously had an employment relationship with this employer, and
- 4) a loan by a legal entity to its founder (shareholder, participant).

Furthermore, the prohibition does not apply to the possibility of granting of a loan by one individual to another, under the condition that the loan is not provided for business purposes. In all other cases, the provision of money loans to individuals is prohibited and such agreements are null and void.

Thus, the right to carry out entrepreneurial activities to provide loans to the population will be provided exclusively to regulated entities, which will ensure adequate protection of the rights and legitimate interests of consumers. Taking into account that there is no proper law enforcement and judicial practice on this innovation yet, it is too early to talk about the effectiveness of the new rule of law.

- **Restrictions on raising loan funds from citizens**

According to clause 3 of the Article 715 of the Civil Code, citizens and legal entities are prohibited from raising money in the form of a loan from individuals as entrepreneurial activity and such agreements are null and void. This prohibition does not apply to banks licensed by an authorized state body, or when accepting money in exchange for securities.

This provision served as the basis for the point of view, that a legal entity or an individual cannot, under any circumstances, raise loan funds from an individual. In the past, tax authorities have sometimes taken this position when providing explanations. However, this ban is intended to protect citizens from fraud and the organization of various "pyramid schemes". Raising money in the form of a loan from individuals as an entrepreneurial activity in other words means accepting deposits from the population with remuneration, which refers to banking operations and requires a license.

The current prevailing point of view is that this restriction applies only to cases of using a loan as a way of doing business. The wording of clause 3 of the Article 715 of the Civil Code means that individuals are not prohibited from lending money and receiving remuneration, but that this money by borrowers (individuals and legal entities) cannot be sought for entrepreneurial activities.



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An individual can give loans, but the borrower should not have the goal of raising loan funds for doing business. For example, if the preposition “for” was employed instead of “as” in the article under consideration, then individuals could not give loans to legal entities at all, regardless of whether or not they have a remuneration under the loan agreement, taking into account that legislative acts should be interpreted according to the literal meaning of their verbal expression.

Based on the foregoing, we believe that, in general, the conclusion of loan agreements providing for the raising loan funds from individuals is permissible, subject to the restrictions mentioned above. It is worth mentioning that in order to avoid controversial situations in the loan agreement itself, we recommended to avoid such wording as: “the loan is transferred for the purpose of business activities of the Borrower” or “the loan is targeted - for the purpose of commercial activities by the Borrower”, etc.

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