Kazakhstan's Gold Mining Sector and the New Regulation on Gold Sales

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In their article, Michael Wilson and Elena Lee review current gold production in Kazakhstan and consider how new regulations are impacting on domestic production capacities and gold sales. Their conclusion is that they expect, at least for the foreseeable future, that Kazakhstan will refine all the gold it produces and also that the National Bank will exercise the State's priority to purchase all gold bullion produced in the country.

Kazakhstan currently ranks ninth in the world (third in CIS,[1] after Russia and Uzbekistan) in terms of gold reserves and 25th (third in the CIS) in terms of gold production. According to the Ministry of Industry and New Technologies of Kazakhstan (MINT), the competent body, gold production was 36.6 tonnes in 2011, a 21.1% increase over 2010, including 16.6 tonnes[2] of refined gold.

There is an ambitious plan to increase gold production to 70 tonnes per annum by 2015. Kazakhstan has 293 gold deposits (38% gold-complex, 60% gold proper, 2% placer), but only 149 are licensed or in commercial development.[3]

The total gold resources are estimated at 9,200 tonnes, whilst reserves are at 2,200 tonnes. At current production rates, these will last approximately 19 to 80 years.

The majority of Kazakhstan's gold production comes from the processing of polymetallic and copper ores.

KazZinc (the only LBMA accredited refinery) is the largest gold producer in Kazakhstan, as a by-product of processing polymetallic ores. KazZinc's gold production was 348,000 oz in 2010 and 429,000 oz in 2011[4], which included production from the Vasilkovskoye open pit. It is rumoured that KazZinc will shortly sell its gold assets.

Kazakhmys plc (which is a FTSE 100 company) is the main copper producer in Kazakhstan, with a Boliden built refinery at Balkhash in Central Kazakhstan. Gold production from Kazakhmys Copper was 138,400 oz, grading 0.73 g/t in 2010, whilst Kazakhmys Gold produced 1,401,000 tonnes of ore, grading 1.25 g/t in 2010, and Gold doré production reached 43,100 oz in 2010[5]. It is rumoured that Kazakhmys also wishes to sell its gold assets.

The major gold deposits are located in the North, East and Central Kazakhstan, and are shown on the map below and on page 13.

The largest of Kazakhstan's open-pit gold deposits is the world-class Vasilkovskoye (near Kokshetau), which has been explored since the Soviet times and which was sought by all of Dominion Mining, Placer Dome, Barrick, LonMin, Resolute, Malaysian Mining, Teck-Cominco, Levayev and Gaydamak, but is now owned and operated by Altyntau Resources JSC, an affiliate of JSC KazZinc (itself now part of Glencore International Plc). A gold recovery plant of 8 mtpa was commissioned in May 2010.

Figure 1. Major and perspective gold deposits in Kazakhstan

1. http://www.akorda.kz
2. http://www.comprom.kz
3. According to Tau-Ken Samruk, which is the national holding company established in January 2009 at the initiative of the President of Kazakhstan, Nursultan Nazarbayev, to hold the Kazakh Government's stakes in some of the country's largest metals and mining companies. Tau-Ken Samruk is a subsidiary of the Samruk-Kazyna National Wealth Fund. In late 2009, Tau-Ken Samruk created a subsidiary, Tau-Ken Altyn LLP, for the exploration, development, treatment and refining of gold and silver.
4. http://www.kazzinc.com
5. Source: the corporate website of Kazakhmys plc, http://www.kazakhmys.com

The Bakyrchik deposit, now part of the Kyzyl Project, which also includes Bolshevik (Ust-Kamenogorsk, East Kazakhstan) is perhaps the largest in Kazakhstan, with some claiming it may have 20-30m ounces. Bakyrchik is now owned by Altynalmas Gold Ltd. (which is owned by Ivanhoe Mines and nominees of the Almex Group on a 50/50 basis).

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Kazakhstan's largest historical independent gold producer since 1929 has been the former State-owned Kazakhaltyn, which was bankrupted and privatised in 2003. It is located at Stepnogorsk, north of Astana and has three mines at Aksu, Bestobe and Zholymbet. MMC Kazakhaltyn JSC was acquired by Polyus Gold OJSC when it took control of KazakhGold Plc from the Kazakh Assaubayev Family in August 2009. Current production is 95-100,000 oz per year from underground, open-pit and tailings. Polymetal OJSC (Nesis) bought the Varvarinskoye gold deposit (130 km from Kostanai) in 2009 from Orsu Metals Corporation. Gold production at Varvarinskoye began in December 2007, after the first project financing was raised for the gold sector from Investec, Nedbank and the South-African Export Credit Agency. By 2013, Polymetal intends to increase gold production to 5 tonnes per year[6]. Hambledon Mining plc (listed on AiM) owns the Sekisovskoye deposit near Ust Kamenogorsk, East Kazakhstan. Underground mining began in late 2011. Hambledon contracted to purchase Akmola Gold LLP (the former Teck-Cominco Company), which owns the Tellur and Stepok deposits, in September 2011, and hopes to complete the purchase shortly. Hambledon now has EBRD as an investor.

Central Asia Resources Limited (listed on the ASX) has five prospects in Kazakhstan (i.e. Dalabai, Altyntas, Bizhe, Kepken and Kengir) with a total resource of 1.28m oz of gold. Altynalmas JSC is the former national company, which after independence operated and managed all of the various gold mines and exploration areas (as the successor to KazZoloto, itself part of GlavAlmazZoloto). After Bakyrchik and Vasilkovskoye were taken away from it under the Kazhegeldin Government, it was left with the Akbakai Underground Gold Mine in the Zhambyl Oblast. It also acquired the nearby Svetinskoye, Beskempir and Kareera deposits. The Akbakai gold processing plant was upgraded in July 2011, utilising a US$50m facility from Eurasian Bank JSC, pursuant to the Government's Programme for the Industrial-Innovative Development of Kazakhstan for 2010-2014.

Impact of the Customs Union on Gold Sales in Kazakhstan

Between the period of July 1998, i.e. when the Presidential Decree *'On State Regulation of Relations Connected with Precious Metals and Precious Stones'* of 20 July 1995 that had the force of a law was abolished, and 1 January 2010, there was no regulation of gold sales and exports in Kazakhstan, domestic sales attracted VAT at the standard rate (now 12%), whereas export sales were zero-rated, and local refining at Ust-Kamenogorsk (LBMA accredited) or Kazakhmys' Balkhash refinery also bore VAT and was relatively expensive. There was little domestic market demand for gold; although since independence, the National Bank of the Republic of Kazakhstan (NBK) has been a regular purchaser (see below).

Unlike India, the Kazakhs have not, historically, been large believers in and consumers of gold, and gold does not have the same place in society, where reverence is still paid to the US dollar and cash is king.

Producers typically chose to export their concentrates or doré for final refining and sale, and then seek to claim a refund for their excess VAT inputs.

This began to change with the Customs Union of Russia, Kazakhstan and Belarus (CU) from 1 January 2010.

The CU countries adopted a package of regulations relating to the operation of the CU, which included a special resolution on common non-tariff regulation, introduced a single list of goods, the import of which to non-CU countries and the export of which from the CU to non-CU countries are subject to prohibitions and restrictions. Such goods include precious metals, such as gold, silver, platinum and platinum-group metals.

The application of the CU regulations on precious metals was postponed in Kazakhstan until 1 July 2011, and certain new regulations became effective only from January 2012.

Regulatory Novelties

To implement the CU restrictions, in July 2011, the President signed a Decree, introducing non-tariff regulation of precious metals, specifically:

(i) State control over the import from non-CU countries, and the export to such countries of gold and raw materials containing gold, to create incentives for the development of the domestic gold market and processing of gold in Kazakhstan, Russia and Belarus; and

(ii) A priority right of the State to purchase gold bullion designated for export, in order to increase the gold reserves of the NBK.

Export of Gold and Raw Materials Containing Gold

In August 2011, the Government adopted rules as to the export/import of gold (in all forms) to and from Kazakhstan, and to and from non-CU countries, as well as raw materials containing gold.

Currently, in order to export gold and raw materials containing gold to non-CU countries, an export licence should be obtained from the Industry Committee within MINT.

Location	Gold Deposits
North Kazakhstan	Vasilkovskoye, Varvarinskoye, Uzboi, Symbat, Komarovskoye, Elevatornoye, Akkarginskoye, Zhetygorinskoye
Central Kazakhstan	Aksu, Zholymbet, Bestobe, Maikain, Kvartsytovye Gorki, Ushoky, Yenbekshi, Pustynnoye
East Kazakhstan	Bakyrchik, Suzdalskoye, Sekosovskoye, Bolshevik, Vasiliyevskoye, Ridder-Sokolnoye, Zhanan, Akzhal, Kaskabulak
South Kazakhstan	Akbakai, Altyntas, Ddlabai, Aksakal-Beskempir, Mynaral, Zharkulak, Karamurun, Arkharly, Kumysty
West Kazakhstan	Yubelienoye

6. Source: http://www.newskaz.ru/economy/20100317/490895.html

An exporter of precious metals can only be a legal entity or individual entrepreneur: (i) which is registered in Kazakhstan; (ii) owns precious metals or has entered into an agency agreement with the owner of precious metals; and (iii) which is entitled to engage in transactions with precious metals, in accordance with the legislation of Kazakhstan. In addition, an exporter must be on a special registry of MINT.

The export of raw materials containing gold to non-CU countries is permitted only for the purpose of export or refining.

In order to increase utilisation of the existing refinery capacity (the LBMA accredited refinery of KazZinc/Glencore at Ust-Kamenogorsk and the Balkhash Refinery of Kazakhmys), an exporter of raw materials containing gold outside of the CU should, prior to exporting, obtain consent from MINT in the form of either an export opinion (for export) or refining opinion (for refining) that in Kazakhstan the commercial recovery of gold from raw materials or refining, respectively, is impossible or uneconomic. In order to obtain such an export or refining opinion, an exporter needs to make a filing with MINT. When issuing an export or refining opinion, MINT should consider the terms of the export contracts and applicable prices for refining provided by Kazakhstani refineries.

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As noted, currently, KazZinc (part of Glencore International Plc) is the only company that can comply with the *London Good Delivery* LBMA international standard. Kazakhmys LLP also has refining capacities to produce gold bullions at its Balkhash Refinery, but only in accordance with Kazakhstani (GOST) standards. However, the NBK and the Government intend to encourage and cause the upgrade of Kazakhmys' refining capacities so that, within a few years, it will be the second certified enterprise that can produce gold in accordance with the *London Good Delivery* LBMA international standards. There has also been much talk of the Government/MINT sponsoring, and of Samruk financing, a new refinery.

The current tariffs for refining at Ust Kamenogorsk vary from US$0.22 to US$0.23 per gramme (100% advance payment), plus transportation and other costs (insurance) at US$0.0195 per gramme.

The Balkhash refinery tariffs for refining of doré to 99.9% gold are US$0.1 per gramme, excluding VAT.

The current political and commercial intent is to fully utilise the existing domestic refinery capacity, and if that is achieved, at current production rates, it should be possible for the foreseeable future for Kazakhstan to refine all of the gold that it produces.

This is not resource nationalism, but economic and commercial common sense, in that Kazakhstan had refineries that were underutilised, even though domestic costs are relatively low, and reflects Kazakhstan's push to move further downstream in the value chain.

The State's Priority Right to Purchase Gold Bullion

The State has a priority right to purchase gold bullion and other precious metals that are produced by subsoil users.

In order to export gold bullion from Kazakhstan to non-CU countries, an exporter should, therefore, apply for and obtain, apart from an export licence, as noted above, a decision of the NBK to waive the exercise of its priority right to purchase gold bullion. NBK has been vested with powers: (i) to decide on behalf of the State whether or not to exercise the State's priority right to purchase gold designated for export, which became effective from 8 January 2012; (ii) to control export transactions of second-tier banks (i.e. any bank below the NBK) with gold bullion; and (iii) to control the testing and sampling of alloys of gold and raw materials containing gold, which are exported/imported from or into Kazakhstan.

As a practical matter, firstly, suppliers submit to the NBK their forecasts for production and sales twice per year, for the first and second six months of a year.

Based on the forecasts for production, the situation in the monetary market and international financial market conditions, the NBK either approves the limit for the purchase of gold bullion through the exercise of the State's priority right for the coming six months or waives the priority right for the coming period, i.e. from one month to six months. The NBK then determines the volume of gold bullion to be purchased from a particular supplier within the approved six-month limit of gold bullion purchases.

If the NBK decides to exercise the State's priority right, the NBK and the supplier enter into an agreement as to the terms of the sale and purchase of gold bullion, as well as sign a trade ticket (i.e. a contract passport) for a particular lot.

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The price of gold bullion offered for sale, and to be purchased by the NBK, should be set out in the local currency, tenge (KZT). The price depends on the weighted-average currency rate of the KZT to the US dollar as of the date preceding the transaction, as well as the average value of the morning and evening fixings of gold at the LBMA, averaged for the whole month of the delivery and with the discount to be calculated taking into account the following:

- Transportation and customs costs, as compared to the export of gold to international markets;
- Expenses as to the sterilisation of monetary overhang in the system;
- The bid offer spread; and
- A discount for quality of gold bullions that do not comply with the *London Good Delivery* standard.

It is not yet clear what is meant by the use of the phrase *'sterilisation of monetary overhang'* and what amount of expenses associated with such will be included in the discount. In order to support domestic local gold producers, the NBK, together with the Association of Mining and Metallurgical Companies, is considering possible advance payment schemes.

The waiver of the State's priority right may be issued by the NBK if it reaches its limit for the purchase of gold bullion or whenever it decides to waive the State's priority right for a certain period (i.e. from one month to six months), and the relevant decision should be published on the NBK's website.

7. For more information please refer to the NBK's website: www.nationalbank.kz

Role of the NBK on the Gold Market

The NBK is the central bank of Kazakhstan that is separate from the Government as the executive branch and reports to the President of Kazakhstan. The Chairman of the NBK (currently, Gregory Marchenko) is appointed by Decree of the President.

The NBK has been steadily accumulating gold and other precious metal assets as the following table shows[7]:

Year	Precious Metals
2007	US$1.812bn
2008	US$2.001bn
2009	US$2.501bn
2010	US$3.052bn
2011	US$4.151bn
1 March 2012	US$5.281bn

In August 2011, the NBK stated that it intends to exercise the State's priority right to purchase all gold bullion, so that domestic producers who comply either with London Good Delivery or Kazakh standards will have a guaranteed customer of their products in the next few years[8]. On 15 March 2012, the Chairman of the NBK[9] was quoted as saying that the NBK began exercising the priority right from November 2011 and, as a result, has already purchased around 20 tonnes of gold. This means that within the next two to three years, no gold bullion will likely be exported from Kazakhstan. Kazakhstan also has a National Oil Fund, which was created in 2000 as a stabilisation fund that is intended to accumulate windfall revenues from oil sales and to seek to ensure the economy will be stable against the price swings of oil. The assets of the National Oil Fund are monitored by the NBK. As of 1 February 2012, the assets of the National Oil Fund were US$45.5 billion.

New VAT Regime on Gold Sales

Historically, VAT was charged on domestic transactions in gold, but this was changed with effect from 1 January 2012.

Sales by gold producers of refined gold from raw materials of their own production to the NBK are now taxed at a zero rate of VAT, whilst sales to a buyer, other than the NBK, are exempt from VAT, provided that such gold is sold within Kazakhstan.

Conclusion

Raw materials containing gold can now be exported only for the purposes of export and refining, and only on the basis of a special opinion from MINT. Kazakhstan is taking all measures to upgrade and ensure the full utilisation of the existing refinery capacity at KazZinc and Kazakhmys, and if this is achieved, it is likely to result in Kazakhstan refining all of the gold it produces within the country for the foreseeable future.

Compliance with the procedure for the exercise of the State's priority right to purchase gold bullion will make the export of gold bullion a complex and lengthy process, if not almost impossible, at least within the next two to three years, and this is especially so considering the intention of the NBK to exercise the State's priority right to purchase all gold bullion produced in Kazakhstan for the next few years.

However, in general, these changes are positive and, particularly, the amendments to the Tax Code as to the elimination of tax barriers on trades with gold bullion within the country should help motivate domestic gold producers to further develop their production and the gold market in Kazakhstan.

8. NBK Pres Release No26 Of 2.3 August 2011
9. Online Conference on www.profinance.kz held on 15 March 2012

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Prior to MWP, Michael was the founding partner of all of Baker & McKenzie's offices and its entire practice in Central Asia, and the Caucusus. He has more than 13 years of experience in London and Sydney, and has now practised in Central Asia, the Caucusus, Russia and the Ukraine for more than 17 years. He specialises in mergers and acquisitions, especially in the mining, and oil and gas sectors, as well as corporate, joint ventures, banking and project financing. He has structured, documented and advised on almost all of the major mining, oil and gas and natural resource transactions in Kazakhstan, Uzbekistan and the Central Asian Region to date, including Sukhoi Log, Lenzolotto, Aksu, Bestobe, Zholymbet, the Bakyrchik, Vasilkovskoye, Varvarinskoye, Zarmitan, Kumtor, Jeeroy, Taldy-Bulak, Amantaytau and Dagystau Goldfields Projects, and also further afield, namely the Mt. Morgan Gold Mine in Queensland, the Vatukoula Mine in Fiji, to name but a few. He is a Member of the Major Projects Association; Founding Member of the Business Lawyers Association of Kazakhstan; a Founding Member of the Foreign Investors Council under the President of the Republic of Kazakhstan, a Founder and the former Treasurer and Chairman of the European Business Association of Kazakhstan (1998 to 2004); Member of the American Chamber of Commerce in Kazakhstan.

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Elena belongs to the MWP Banking & Finance Group that works extensively with financing and securities, project financing, credit financing and loans, mergers & acquisitions, and issues related to Islamic banking. Elena specialises in Capital Markets, Banking and Finance, Corporate, Project and Corporate Finance, and Currency Issues. Her legal expertise in the sector lies in Mining, Energy and Commodities Trading, Commodity Derivatives and Metal Trading Activities, securitisation opportunities and potential leasing structures for rolling stock, various derivative products. She qualified as a lawyer in, and has been practicing since 2004, and subsequently won a scholarship, and obtained a Cum Laude Master's Degree (LL.M) in International Business Law from the Tilburg University, Netherlands in 2009, for outstanding academic performance.