INTERNATIONAL SCHOOL
OF ECONOMICS KAZGUU

International School of Economics

Bolatova Kamilla
Kairullina Daniya
Kozinova Zhamilya

Prospective consequences of AIX and KASE merger

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Abstract

Back in 1993, one of the first stock exchanges in Kazakhstan, KASE, was founded. Since the national currency, the tenge, was introduced on November 15, 1993, KASE's main task was to develop the national currency market. While AIX, which appeared in 2017, was focused on attracting foreign investors in the development framework of AIFC. After the announcement of the merger of these two exchanges, there were questions about the possible consequences of the merger, which this study addresses. The purpose of the study is to identify what kind of possible outcomes in terms of market efficiency and liquidity could appear because of the impact of KASE and AIX merger. In this article we evaluate possible outcomes by examining hypotheses through the interview and examined secondary data by case study and SWOT analysis. During research we discovered that hypothetical consequences depend on several factors such as regulatory and legislative framework, organizational structure and others. Also, during the interview, it was revealed that experts of different fields have different opinions, but each of them supports the fact that the merger of stock exchanges is an important part of economic development of Kazakhstan and still it will help to increase the liquidity of the market, attracting foreign investors.

Moreover, results of SWOT analysis showed that the merger presents several strengths including the creation of a robust and more liquid market, enhanced optimizing processes, workflows and cost savings, while also facing challenges such as technical integration, aligning different regulatory frameworks and resistance from stakeholders. It creates opportunities to stimulate the economy and stock exchange indicators during a merger due to new opportunities in the development of Kazakhstani legislation and at the same time has a number of risks associated with the composition of the shareholders of one of the exchanges.

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Introduction

Kazakhstan Stock Exchange (KASE) and Astana International Exchange (AIX) stock exchange merger process is the hottest topic in finance today.

As already known, stock exchanges are unique businesses because there is often one dominant exchange in each country (Philips et al., 2014). So, on September 20, 2023, it was published that the exchanges of KASE and AIX planned to merge. Moreover, in an official press release the head of state of the Republic of Kazakhstan was announced the subsequent prioritization of the development of the country's stock market. Kassym-Zhomart Tokayev[1] that “the functioning of two exchanges is redundant for the financial system of our country. Indeed, in many ways, exchanges duplicate each other, and sometimes even compete with each other”. It is possible to entrust the issue of combining the potential of exchanges under a single management, but this merger may face several heterogeneities and potential challenges. The consequences of this kind of merger are largely unknown. Such a decision involves various aspects of interest, both economic and regulatory, that affect not only the overall liquidity pool or efficiency of the markets, but also investors, firms, financial intermediaries and the economy as a whole (Nielsson, 2009).

Previous studies examining the impact of stock exchange mergers have only focused on improving market liquidity (Nielsson, 2009) and the impact of stock exchange mergers on market efficiency (Khan & Vieito, 2012; Yang & Pangastuti, 2016). Moreover, it is widely acknowledged by writers that attempts at cooperation, including mergers, between stock and derivatives exchanges represent a novel approach to boosting the value of stock markets (Dorodnykh, 2012). Many scholars and studies have shown the significant effects that stock market integration has on various stakeholder types (Dorodnykh, 2012). Recent studies have provided theoretical and empirical explanations for the reasons behind mergers. However, the body of literature is still lack of attempting to analyze the risks of stock exchange integration.

[1] For more information: https://forbes.kz/actual/officially/tokaev_predlojil_obyedinit_fondovyie_birji_kase_i_aix/

Furthermore, there is some evidence to suggest that processes of integration between exchange markets may also be determined by hidden factors around the world. Eventually, followed by this, our research is based on analyzing current position of stock exchanges by reliable and independent opinions of finance experts to establish potential risks, benefits and consequences of merger and impact its practice in Kazakhstan.

Research questions

1. Does the merger of exchanges and the absence of arbitrage contribute to increased market liquidity?
2. What significant differences present barriers to exchange consolidation at the moment?
3. What factors should be considered for a successful exchange merger?
4. What potential outcome is expected regarding the merger?

This study may be useful for future research regarding stock exchange mergers in Central Asia. Potential consolidation is interesting due to the current specifics of stock exchanges: being based in different jurisdictions, a significant difference in the number of issuers, instruments, as well as subordination to different regulators. Thus, the findings of this research contribute to the existing literature on stock exchange mergers and provide valuable insights for finance enthusiasts, investors and stakeholders. It is the first research that analyze first historical consolidation in Kazakhstan stock exchange industry. Moreover, this study is the first to examine the possibility of a merger between stock exchanges in emerging markets. The stock exchanges of developing Central Asian countries are connected for the first time. This research attempted to contribute to the knowledge base by investigating overview of the domestic stock exchange industry. This study examines investigating the impact of the KASE and AIX merger on the market efficiency and liquidity; identifying where possible outcomes could appear in terms of traders' portfolios. In particular, this thesis aims to assess comprehensive understanding of the potential merger between

KASE and AIX stock exchanges on investor behavior, regulatory framework, economics and business development success and recommendations.

Hypotheses

H1: KASE is acquirer, AIX is target.

H2: AIX will acquire KASE.

H3: Destruction of one of the exchanges.

H4: Conception of a single holding company for exchanges with a single center for making corporate decisions.

Lastly, in fact diversification, separation of exchange operations, and the reduction of bureaucratic and duplicative expenses through exchange mergers should encourage consolidation. This process should draw liquidity, new international institutional investors, and additional listed firms.

Literature Review

The current section of this thesis is intended to analyze existing academic literature about stock exchange mergers in financial industry, factors influencing merger success and case studies of previous mergers in similar contexts.

Stock Exchange mergers in the Financial Industry

Stock exchange mergers have been a core trend in the financial industry, with various studies examining their impact, motivations, and implications. In this section the impact of stock exchanges and the motivations behind such mergers will be discussed.

A series of studies have investigated the motivations behind stock exchange mergers in the financial industry. Arnold et al. (1999) explored the motivations driving stock exchange mergers. The study highlights the main motives for stock exchange mergers such as cost savings, increased market share, and access to new markets. Mergers also enable exchanges to broaden their range of products, reduce competition, and strengthen their bargaining power with regulators. In a similar vein, research by Hasan et al. (2010) examined different growth strategies employed by stock exchanges and their impact on value creation. Their findings indicate that mergers can be an effective strategy to bolster market positions and create value for stakeholders.

Furthermore, the impact of stock exchange mergers on market liquidity and efficiency is a subject of debate in the literature. Firstly, it is better to explore the concepts of market liquidity and efficiency in order to have a clear understanding of how these factors affect the success or failure of mergers in the stock market. The concept of market liquidity has been around at least since Keynes (1930). Although considerable time has passed, a consensus definition has emerged. Several recent studies define market liquidity as the ease with which assets can be bought or sold in the market without affecting their price. It is usually measured by trading volume, bid-ask spreads and market depth. High liquidity implies that trades can be executed quickly and with minimal impact on price, while low liquidity indicates the opposite. Kyle (1985) presented a model linking market liquidity to informed trading, suggesting that higher liquidity allows for better price discovery, as it attracts informed traders who provide valuable information to the market. Furthermore, liquidity is found to have a significant effect on the cost of capital and investment decisions of firms (Chordia et al., 2000).

Moreover, it should be noted that market liquidity depends on several factors that could affect the demand, supply and overall, willingness of market participants to transact. Borio (2000) mentions the factors affecting the level of market liquidity:

1) Trading volume. A large number of trades enhance liquidity by indicating a substantial presence of both buyers and sellers in the market.
2) Transaction costs. Lower costs associated with trading, such as commissions and spreads, encourage active participation among market players, thereby fostering liquidity.

3) Participant diversity. The involvement of various types of investors such as private, corporate and institutional investors, as well as traders and speculators in the market boosts liquidity by increasing the probability of finding a trading partner.
4) Regulation and transparency. Effective market regulations and transparent practices may help to increase confidence among participants, mitigating investment risks and consequently promoting liquidity.
5) Volatility. A high level of volatility may discourage potential investors due to the unpredictability of market changes, thereby reducing liquidity as participants become less willing to engage in buying and selling during volatile periods.
6) Other external factors. Geopolitical events and political stability can significantly impact market liquidity, creating conditions for changes in market.

Furthermore, analyzing the effects of stock exchange mergers on various aspects of the financial market, the existing literature has investigated that the merger of two or more stock exchanges can lead to increased trading volume and larger order books, which can reduce bid-ask spreads and transaction costs, thereby improving liquidity. However, mergers may also result in decreased liquidity, particularly if there is a lack of consolidation within the order books or if there is a reduction in the number of market makers (Yang & Pangastuti, 2016; Nielsson, 2009).

Market efficiency, another crucial market characteristic, is primarily defined by the Efficient Market Hypothesis (EMH) formulated by Eugene Fama in the 1970s. The EMH states that asset prices fully reflect all available information, implying that it is impossible to consistently achieve returns above the average risk-adjusted market return by expert stock selection or market timing. According to Fama (1970) market efficiency can be categorized into three forms: weak, semi-strong, and strong. The weak form assumes that prices reflect all past trading information; the semi-strong form asserts that prices reflect all publicly available information; and the strong form asserts that prices reflect all information, both public and private.

Moreover, stock exchange mergers can have both positive and negative impacts on market efficiency. Charles et al. (2015) explored the effect of stock exchange mergers on market efficiency by analyzing a range of factors that can affect market efficiency, including the maturity and size of the markets being merged, and different types of mergers (developed markets versus developing markets; domestic stock exchange mergers versus cross-border stock exchange mergers). The study suggests that mergers have the potential to improve market efficiency through reductions in transaction expenses, enhancements in liquidity and promotion of increased competition. These factors contribute to a more efficient market environment by facilitating smoother trading, lower costs for investors, and a more competitive landscape that benefits market participants. However, mergers can lead to reduced competition, increased market power and higher trading fees, which can negatively affect market efficiency. Reduced competition can lead to reduced innovation and higher barriers to entry, while increased market power can lead to monopolistic behavior that hinders market efficiency (Nielsson, 2009).

In summary, stock exchange mergers can have significant impacts on market efficiency, liquidity, and competition. While motivations for mergers often revolve around the strategy of growth and value creation, their impact extends to key aspects such as liquidity and market efficiency. Empirical evidence suggests that while mergers can provide benefits such as cost savings, increased market share, and access to new markets, they can also lead to negative consequences such as reduced competition, increased market power, and higher trading fees. However, the effectiveness of mergers may also vary depending on factors such as the unique characteristics of the regional market and regulatory environment (Yang & Pangastuti, 2016).

Factors Influencing Merger Success

As the practice of uniting exchanges in other countries shows, which is discussed in more detail in the next section, merging exchanges share the accumulated experience and improve the methods and trading conditions. In the best case, the efficiency of exchange activity increases and they strengthen their position on the world arena as a more competitive unit. However, it is important to consider factors that vary depending on the type of integration and further affect the merger process of exchanges. Since AIX is an international stock exchange and KASE is Kazakhstan-based, it can be noted that this is a type of domestic merger. Since both exchanges are still domestic, the main purpose of their merger is to attract more foreign investors.

Exhibit 1, types of exchange consolidations (Jordan, 2016).

Type	Summary
Domestic merger	Two or more domestic exchanges merge into a single national exchange, which could attract foreign investors.
Regional/global merger	Two or more domestic or regional exchanges (trading the same securities) merge into a regional exchange.
Vertical integration	A single exchange takes ownership of clearing, settlement and depositary institutions.
Niche integration	Exchanges trading in specific securities, such as derivatives, merge into a niche regional or global exchange for that particular security.

Organizational structure

It should be noted that in the current situation both exchanges engage with the same professional market participants and the same sets of securities. However, the structure and platforms differ due to the jurisdiction of each party, so one of the factors is the organizational structure.

In the research of AIFC representatives the organizational structure of KASE was determined according to the Kazakhstan legislation, thereby it is divided into 3 platforms: main platform, alternative market and mixed market (Manayenko & Iminov, 2024). While the structure of KASE was indicated in Research of

Halyk Finance[2] as "diversified business due to the functioning of four main markets: currency, stock (securities), money (repo and swap operations) and derivatives market".

Other than types listed in table above there are also another view of subjection, how integration of markets can be sub-divided. Several integration models can be proposed as phases leading up to a fully integrated stock exchange, generally they are international business transactions, domestic mergers and restructuring, remote membership, cross-listing, cross-membership, and other alliances (Shy & Tarkka, 2001; Hasan & Schmiedel, 2004; Armanious, 2007; Nicolini, 2010). Considering this point of view, it is noticeably seen that domestic merger can also be defined as restructuring. Because the merger in this case involves restructuring the existing KASE or AIX platforms to combine them into a single form.

Regulatory jurisdiction

The second factor which plays an essential role in merger is regulatory jurisdiction. Since AIX was formed in 2017 as part of the development of the Astana International Financial Center (AIFC), it operates in a legal and regulatory environment - in the jurisdiction of English law in compliance with the AIFC. It means that all operations regarding AIFC members straightforwardly related to AIX. It also important to notice that jurisdiction of English law gives an opportunity for international investors to operate in a safe area with some tax preferences. While KASE as one of the first domestic a stock exchange that operates in accordance with the laws of the Republic of Kazakhstan. Its operational process contributes traders and their clients the opportunity to actively conduct transactions on several markets with different types of financial instruments. Noticing this difference, we can conclude that one of the main factors influencing the success of the merger is regulatory jurisdiction.

[2] For more information: https://halykfinance.kz/download/files/analytics/AC_kase_aix.pdf

Technology Integration

One of the next factors is technological integration. The main reason for including this item in the list is the fact that as the exchanges merge, online servers and websites for participants will be merged into one structure. As well as the basic operating procedure, any transaction requires a suitable process flow. Since any merger requires a smooth transition, it is important to consider these points:

1) Ensuring continuity of trading. This means that it is important to keep the duration of trading, what can be achieved by establishing possible mistakes and gaps that will later grow into larger problems with operational transactions. At this point in time, the data shows[3] that "Information on the course of trading in financial instruments conducted by the Exchange, provided during the trading day in a continuous flow with a 15-minute delay"
2) Capability of efficiency. In case of successful technological integration, namely the appropriate merger of clearing and settlement systems, increases the level of efficiency regarding the transaction volumes. Furthermore, in the long term, shorter order processing times and reduced operational delays can be expected.

Technological integration can also allow you to identify the mistakes of past examples and build on that experience foundation as an aspect of maintaining the confidence of market participants and investors. Therefore, a successful merger requires seamless integration of technology systems to ensure smooth trading operations, efficient order coordination and reliable dissemination of market data.

Operational Efficiency

When talking about operational efficiency as a factor for a successful merger, the common goal of the two parties is to optimize their operations and achieve higher levels of profitability. There are several points which is used to accomplish this goal:

[3] For more information https://kase.kz/ru/services/

1) Optimizations of operations. As with technology integration, operational efficiency can be achieved by simplifying processes on the basis of past experience. This means identifying similar functioning roles between departments and consolidating them into one body to reduce costs and increase efficiency. Considering this point, it is important to notice that cost reductions in terms of technical support, rent, and other operating costs are, generally, the reason for the reduction of the overall cost of the regulated body.
2) Optimization of the resource: This involves rationalizing the use of financial, human, and other resources to improve efficiency. For example, the issue of employees and reallocation will be raised during the merger. That is why after the final results it is important to take into account the performance of employees under the new structures in order not to give in to the optimization of human resources.

In general, there are many factors influencing the merger, but given the current situation and historical background, it is reasonable to identify more significant factors such as organizational structure, regulatory jurisdiction, technology integration, and operational efficiency.

Case Studies of Previous Mergers in Similar Contexts

This section analyzes case studies of previous mergers within similar contexts to provide insights into potential consequences for the AIX and KASE stock exchange merger. By examining past mergers in comparable settings, we can identify trends, challenges, and outcomes that may inform our understanding of the prospective merger between AIX and KASE. These case studies offer valuable lessons and benchmarks for evaluating the potential benefits and risks associated with the integration of two stock exchanges.

Previous findings from the comparative literature confirm that the trend of stock exchange mergers to expand the business and capabilities of exchanges is a global trend (Dorodnykh, 2014). Among capital market institutions, exchanges have been and remain the most visible and vocal. Despite previous waves of demutualization and consolidation, exchanges remain unique institutions. Even where similar structural reorganizations have occurred, the underlying factors driving such moves are quite different. Some exchanges such as Luxembourg and Switzerland are bucking the trend towards both consolidation and demutualization (Jordan, 2016).

Exhibit 2, Historic stock exchanges mergers

Date	Acquirer	Target	Duration
2007	**NYSE**	**Euronext**	**1 year**
2008	**CME Group**	**NYMEX**	**6 months**
2011	Deutsche Borse	NYSE Euronext	1 year
2013	ICE	NYSE Euronext	8 months
2014	**Shanghai Stock Exchange (SSE) and Hong Kong Stock Exchange (HKEX)**	**Mutual Market Access**	**7 months**
2016	London Stock Exchange	Deutsche Borse	1 year
2017	Hong Kong Exchange and Clearing	London Stock Exchange	6 months
2020	LSEG	Refinitiv	1.5 year
2023	Shanghai Stock Exchange	Shenzhen Stock Exchange	1 year
2024	**KASE**	**AIX**	**Ongoing**

Source: World Federation of Exchanges 2023 Report (see http://www.world-exchanges.org

Exhibit 2 illustrates major mergers and acquisition events involving significant stock exchanges and financial institutions from 2007 to nowadays. It highlights the dates, acquiring entities, their targets and duration of processes.

NYSE-Euronext

The 2007 merger of Euronext with the New York Stock Exchange (NYSE) marked a major consolidation of the world's exchange system. By fusing Euronext's knowledge of European markets and derivatives with the NYSE's skills in equity trading, the merger sought to establish a transatlantic exchange powerhouse. Cultural differences, technological complexity, and regulatory obstacles all challenged the integration process. Over time, nevertheless, cost savings, increased market penetration, and synergies in product offers were achieved.

NYMEX-CME Group (2008)

The Chicago Mercantile Exchange (CME) proved the worth of merging complementing product offerings and clearing capabilities when it acquired the New York Mercantile Exchange (NYMEX) in 2008. The combined company improved its market position and capabilities by combining CME's financial derivatives with NYMEX's energy and commodities contracts Its sources of income were varied. These case studies highlight the dynamics and complications of exchange mergers, such as the need to balance strategic considerations with regulatory scrutiny and difficult integrations.

SSE and HKEX (2014)

Shanghai Stock Exchange (SSE) and Hong Kong Stock Exchange (HKEX) - are a unique experience in expanding channels for mutual access to the Asian stock exchange market. The key point is that it is, in fact, a cross-border investment channel connecting both exchanges. Therefore, without the merger process, only promoting two-way openness and the healthy development of the capital market. This outcome of events also applies to a domestic merger, supported by hypothesis H4.

Methodology of the study

To obtain data that will lead to the necessary the identification of factors that influence an outcome on this study and answer the core questions, the methodology of the project was chosen to be a qualitative approach. Analysis of documents such as reports, press releases and official statements was carried out, as well as collection of secondary data from publications and studies. In order to gather insights data collected and conducted via web-based platform, especially Microsoft Teams and Instagram (Direct Messages) interviews with 3 participants with open-ended questions and responses. Three financial experts naming had participated in our thesis statement answering a list of open-ended questions. This section of the study records the correlations that were found after analyzing the main ideas and observations from each expert. Data gathered in research would rely on secondary data from main websites to use official statistics and the view of participants related to the new merger.

Moreover, there are sufficient factors as “what can influence merger” and “what is historical background of other mergers” which are observed via case study. It was decided to analyze cases with “NYSE-Euronext”, “CME Group-NYMEX” and “**S**hanghai Stock Exchange (SSE) and Hong Kong Stock Exchange (HKEX)” in order to to draw a line between common goals and similar characteristics before the merger: creating a global platform for increasing liquidity, diversifying products and attracting international investors and strengthening financial integration at the domestic merger level.

Anticipated ethical issues

Here are some of the ethical issues that may arise:

1. Participants must be fully informed about the survey's purpose, how their data will be used, and any potential risks or benefits of participating. They should also be given the option to withdraw from the survey at any time.
2. Researchers should disclose any potential conflicts of interest that may arise from the survey, such as financial or personal relationships with the companies involved in the merger.

Understanding the significance that individuals or groups assign to a social or human problem can be accomplished through qualitative research (Creswell & Creswell, 2018). The worldview of the study is social constructivists. The purpose of the study is to rely as much as possible on the opinions of three participants about the studied situation of the merger of exchanges in Kazakhstan. Thus, the selected case study is a research design that involves an in-depth analysis of the process. Since a sufficient sample has been collected, collecting fresh data no longer generates new ideas or reveals new ones characteristics. Thus, the sample size, that is, the number of interview participants, was determined by this approach.

Research Finding and Analysis

Stock Exchange Profiles: Overview

This section of the study provides an overview of stock exchange profiles based on key indicators: major shareholders, products, regulation and jurisdiction, technology and infrastructure and tax policy, which will be described in more detail in subsequent parts.

Shareholders

In 2017, with the aim of developing the Astana International Financial Center, the Astana International Exchange was created. The main shareholders of the exchange are the Shanghai Stock Exchange (SSE), the Silk Road Fund and the NASDAQ exchange.

At the same time, KASE is a commercial organization operating as a joint stock company. The key shareholders of the exchange are National Bank of the Republic of Kazakhstan (NBRK), the Moscow Exchange (MOEX), banks and investment companies, as well as individuals. Due to the current political and geopolitical instability in the world, despite the fact that the Moscow Exchange is a strategic partner and shareholder of KASE, the risk of sanctions being imposed on MOEX is still present. At the moment, MOEX owns 13.14% of the shares of the Kazakhstan Stock Exchange. In general, KASE is attentive to sanctions compliance. Over the past year, KASE has strengthened compliance with the sanctions regime, including in relation to Russian issuers and beneficiaries in the form of delisting a number of securities on the stock market. Moreover, Alina Aldambergen, CEO of KASE, also stated[4] at the briefing that the

[4] For more information: https://kz.kursiv.media/2023-02-24/lgtn-yandex-2

company will not stop cooperation when faced with sanctioned persons. At the moment, the Moscow Exchange is not under sanctions.

Products

Astana International Exchange (AIX) offers a variety of financial products designed to cater to different types of investors and issuers. The key focus is on the security market. At the same time, there are 4 markets on KASE: foreign exchange, stock (securities), money (repo, swap) and also derivatives. More than 97% of trading at KASE takes place in the money and foreign exchange markets.

Regulation and Jurisdiction

KASE operates under the regulatory framework of the National Bank of Kazakhstan, while AIX operates under its own regulatory body, the Astana Financial Services Authority (AFSA). Kazakhstan Stock Exchange is based in Kazakhstan local law, while Astana Interational Exchange takes advantage of English common law jurisdiction. This regulatory regime is considered more familiar and understandable to foreign investors, thus targeting the foreign user. One of the advantages of doing business in the AIFC is the possibility of re-domiciliation from foreign jurisdictions to Kazakhstan. Hannigan and Hardman (2022) claim that re-domiciliation is a process in which a foreign legal entity changes jurisdiction without any interruption to its core business. Companies decide to redomicile based on various factors, one of them being changes or optimization of the company structure. Today, this procedure is a common practice and in Kazakhstan it is available only under the regulation of English law, therefore, under the conduct of business within the AIFC. English law contains concepts that are not characteristic of Kazakhstan law, including re-domiciliation. Procedures for re-domiciliation both from the jurisdiction of another country to the AIFC and from the AIFC to the jurisdiction of another country are provided for in Part 13 of the AIFC Act “Companies Regulation” and is legally defined as “Transfer of incorporation”.

In the general legislation of Kazakhstan, there is no possibility of re-domiciliation. According to Burak and Aymak[5], it is currently impossible to directly transfer a company from a foreign jurisdiction to the general jurisdiction of the legislation of Kazakhstan, and vice versa, within the framework of the legislation of Kazakhstan.

Transfer of listing of Polymetal

The first issuer to move its primary listing from the London Stock Exchange to the AIX and register under the unique legal jurisdiction of the AIFC was the gold mining business Polymetal International plc. (Polymetal), which is among the top ten producers of gold and silver worldwide. According to the 2023 annual review[6], the share of Polymetal shares (shares + GDRs) accounted for 31.1% of total trading volume.

Based on the 3Q 2023 results[7], the re-domiciliation process saw more than 4,000 Polymetal shareholders from the UK, US, Europe and other jurisdictions transfer POLY shares to the AIX Registrar. The impact of the re-domiciliation of a major player like Polymetal can also be traced from the data of market capitalization from the World Federation of Exchanges.

Exhibit 3, Equity - Domestic market capitalization (USD millions)

Exchange Name	Jan'23	Feb'23	Mar'23	Apr'23	May'23	Jun'23	Jul'23	Aug'23	Sept'23	Oct'23	Nov'23	Dec'23	%change Dec'23/ Dec'22 USD

[5] Click here to see full article https://online.zakon.kz/Document/?doc_id=32443073&pos=6;-106#pos=6;-106
[6] https://aifc.kz/uploads/%D0%9E%D0%B1%D0%B7%D0%BE%D1%80%20%D1%80%D1%8B%D0%BD%D0%BA%D0%B0%20%D0%BA%D0%B0%D0%BF%D0%B8%D1%82%D0%B0%D0%BB%D0%B0%202023/Capital%20Markets%20Report%20-%20rus.pdf
[7] https://aix.kz/aix-presents-its-results-for-3q2023/

Astana International Exchange	98.59	93.41	89.89	89.64	84.20	156.92	207.19	2,233.96	595.01	785.09	866.44	2,412.71	3770.2%
Kazakhstan Stock Exchange	47,046.84	49,050.34	47,397.49	50,428.57	50,064.97	50,708.85	53,845.68	55,226.95	56,453.28	56,042.82	58,463.46	58,940.27	29.0%

Source: World Federation of Exchanges (see https://focus.world-exchanges.org/issue/february-2024/market-statistics)

The overall change between December 2022 and December 2023 is 3770.2%, as a result of active trading in Polymetal International securities made a significant contribution to the overall performance of the Astana International Exchange. In turn, the performance of the Kazakhstan Stock Exchange during the year was very stable. The overall change between December 2022 and December 2023 is 29.0%

Technology and Infrastructure

AIX boasts modern trading technology and infrastructure, with a focus on digital innovation and efficiency. KASE has been gradually upgrading its systems but may still lag behind AIX in terms of technological advancements.

Tax policy

Stock market at KASE operates according to standard tax regimes. In the field of special legislation of the AIFC, the offshore segment of the stock market of Kazakhstan operates under preferential tax regimes.

Qualitative Research and Analysis of the Interview

In order to elicit views and opinions from the participants 3 face-to-face interviews were conducted. Three experts naming Andrey Chebotarev (independent finance analyst and owner of one of the biggest economic telegram-channel @FINANCE.KZ), Assylbek Tanashikov (Adjunct Assistant Professor in International School Economics at MNU, CFA and FRM) and Andrey Kudyarov (Teaching Professor at

MNU, Country Tax Manager at Shell Kazakhstan, LLM) had participated in our research answering a list of questions.

Each respondent was assigned a specific area of questions related to their professional activity. Thus, Mr. Chebotarev shared his opinion and views regarding the merger in the context of an economic perspective, as well as in the context of international experience. At the same time, Mr. Asylbek explained the phenomenon of liquidity, attractiveness and efficiency of the stock market depending on the duration of the prospect and history. Finally, the area of questions related to tax preferences and benefits covered the answers of Andrey Kudyarov. In this part of the paper the key points and insights from each expert were analyzed and the identified correlations are recorded.

Andrey Chebotarev

Independent economic commentator Andrey Chebotarev is a frequent guest of news portals regarding the situation on the stock market of Kazakhstan. Thus, his participation seemed most relevant to this study. Andrey has repeatedly shared his opinion about the merger of exchanges. Moreover, his opinion differs significantly from other forecasts. The next paragraph contains an analysis of Chebotarev's answers. Andrey looks positively at the prospect of merging exchanges but characterizes the process not on the basis of international experience. If the problem of merging most exchanges (regional, international) was in clearing and settlement centers, then in the experience of Kazakhstan it is work in various jurisdictions. The financial analyst emphasizes that unification is impossible without physically destroying one of them. Regarding the issue of increasing the capacity and attractiveness of the domestic market, Chebotarev noted that there will not be a significant increase. In most cases KASE is a money market, and AIX is a stock market. Eventually, externally exchanges copy each other, but internally they are completely different technologies.

Andrey also commented on what opportunities and risks current shareholders may face during a merger of exchanges. He notes that there are more risks than opportunities. Moreover, Chebotarev does not see any special opportunities other than reducing bureaucracy and duplicating functions. During an interview with Atameken Business[8], Renat Bekturov, CEO of AIFC, suggested the option of creating a single holding company for the two exchanges, where a single corporate decision-making center would function. In the context of the merger of domestic stock exchanges, we also noted a similar experience of unification on the Shanghai-Hong Kong Stock Connect experience. Andrei Chebotarev believes that such a scenario is quite realistic and most expected. Furthermore, the analyst underscores that, in addition to establishing another holding company, there will be a distinct delineation of the functions of the exchanges themselves: the money market, which includes short-term funds of up to one year, will be managed by KASE, whereas the capital and equity markets, encompassing long-term funds of one year and beyond, will be administered by AIFC.

To sum up, Mr. Chebotarev's conclusion is a unique experience in the history of Central Asia and this process must be approached fundamentally and comprehensive. According to the answers of financial analyst Andrey Chebotarev, hypotheses H3: Destruction of one of the exchanges and H4: for exchanges with a single center for making corporate decisions are confirmed.

Assylbek Tanashikov

One of the participants was Assylbek Tanashikov who is one of the MNU professors contributed to our work by sharing his valuable opinion. The interview was conducted online via video call, and the directed

[8] For more information:

https://inbusiness.kz/ru/tv_programs/exclusive/kogda-obedinyatsya-aix-i-kase-eksklyuzivnoe-intervyu-s-glavoj-mfca-renatom-bekturovym questions were generally characteristically the same, but differed due to the teacher's expertise in a particular field.

First of all, we were interested in what is his perspective considering the initiative to merge the exchanges, to which we received the answer "In general, pretty positive, it will help the Kazakhstani market to increase liquidity". He also noted that unfortunately the market of Kazakhstan is not very developed since the total volumes are small, increasing liquidity will be one of the ways to attract investors. This in turn can possibly make domestic market closely to the efficient line. Consistently, our group was concerned with what is his point of view on the closure (takeover) of a segment of the stock markets and which of the takeover scenarios is more likely. He states: “I think AIX will overtake KASE, because AIX is prevailing by the presence of some benefits that will be interesting. And as a whole AIX is regulated by English law, which will be the closest to interests of foreign investors”. We were also interested in a follow-up question: "What risks could arise when closing one of the funds?". The professor pointed out that among the problems that stand out, primarily operational risks may arise because for a smooth transition it is necessary to transfer current operations and all orders. It is important not to forget about open positions that are stored in the depository and other consequently important reports.

At the recently held press briefing Chairman of the National Bank, Timur Suleimenov, noted that the decision of the National Bank, ARDF and AIFC has already been prepared. In connection with this the following question was asked: "What is the most favorable and, in your opinion, optimal scenario of merger of Kazakhstan stock exchanges has been developed for the next year?". Mr. Tanashikov answered that the general timeline will be not less than a year as minimum from today's news. The reason for this will be due to the complexity of the process, as each stage will include due diligence. Further he also noted that comparison of current Kazakhstani market situation and merger of exchanges in other countries such as Shanghai and Hong Kong are not quite preferable. Citing the examples of larger market shareholders, the

United States and China, he also noted that it would be more appropriate for Kazakhstan to have only one exchange due to the overall size. "While the Shanghai-Hong Kong and Kazakhstan cases are very similar, it is important to consider, in addition to the difference in volumes, the historical connection to the current results. In China, both exchanges had high liquidity because China once prohibited its citizens to invest money in foreign markets. However, from my perspective it would be more appropriate to keep one player as AIX". One of our hypotheses assumes a scenario with a different result. We also assume how widespread opinion that the merger will lead to a new structure, i.e. a new unit in the market. In this regard, we received the following opinion from our interview participant: "Presumably there will be staff reduction and redirection of personnel. But first the legal jurisdiction will be determined, it cannot be denied that each party will try to preserve its operational scheme".

Lastly, the last question was consisted as follows: Would it have been possible to foresee the merger? Mr. Tanashikov responded as follows: "I think so, as the market was not active, it was clear that changes were needed. The original idea was good that investors would come for a jurisdiction based on English law. This would mean that foreign investors would be protected and there would be certain tax preferences for them". Further during the discussion he shared his view on the Head office: "Perhaps there will not be a common platform, but there will be enough people both in Astana and Almaty, because Financial Institute and its main participants are located in Almaty. Their main offices will probably be located in both cities".

In overall, Assylbek Tanashikov's opinion is more preferable closer to H2 and H3, at that he considers that one of the conquered parties will be KASE. Consequently, he noted that there is no scenario of realization of process by H1, however supposes possibilities of H4 with small probability of realization.

Andrey Kudyarov

Another one of the experts who made an impact to our diploma work was Andrey Kudyarov, who is a teaching professor at MNU and one of the well-known in the tax sphere. Our group had prepared 5 questions that shared similar traits, but differed based on the participant's specialized knowledge in a specific subject area and contacted Andrey via online video call.

In response to the question regarding the overall assessment of stock exchanges merger prospects, Andrey Kudyarov believes that the merger is possible as there is a political will, however, it is more likely one exchange will migrate to the other, or in other terms one will acquire the other one. He does not specify the likelihood of success but indicates a preference for KASE acquiring AIX rather than the other way around, as KASE is the more established exchange with a stronger domestic presence. However, he emphasizes that the specifics of such a merger would depend on the tasks and objectives of both exchanges.

In terms of the differences in the legal framework of both stock exchanges (KASE is in the field of legislation of Kazakhstan, AIFC is in English law, in a special jurisdiction created for it), Andrey Kudyarov points out the inflexibility of civil law issues in Kazakhstan, which may not be favorable and pose challenges for investors. He suggests that many civil law issues in Kazakhstan, such as the inability to reduce the capital of a Limited Liability Company (LLC), to do a buyback, repurchasing of shares by the issuing company on the stock exchange, or have flexible corporate governance, are not conducive to investor protection. He also mentions that attempts to make changes in the civil law system have not provided the necessary flexibility for investor protection, on the other hand, AIX might not be willing to undergo testing these legal frameworks.

Next question was whether he agrees with the scenario where the market would be entirely under domestic jurisdiction and regulation. He states neutral on the scenario where KASE acquires AIX or vice versa and the market is entirely under domestic jurisdiction and regulation, but he mentions that the focus should be on analyzing the objectives and tasks set for both exchanges and determining which tasks would fall out or not in the event of a merger.

Regarding the impact of the AIFC tax benefits (the exemption of interest and dividends from corporate income tax) on investors' decisions, he expresses that the tax free policy are significant for those entering the public capital market, however, usually, the decision to enter the public market is not only related to taxes, as taxes are done for attractive extra, therefore, there might not be effect of tax benefits during the process of the merger, but if there are specific business objectives, then there could be the effect.

In answering the following question about overall tax risks and potential risks of entire market moving to AIFC jurisdiction, Andrey Kudyarov suggests that a merger of the exchanges could lead to a reduction or increase in revenue to the budget, but note that the benefits offered by both exchanges are largely duplicative, therefore a merger may not have a significant impact on tax risks. Moreover, it is better to make thorough analysis of the issuers and the implications of tax benefits, however, he mentions that there might not be a substantial change or effect after the merger. Furthermore, he believes that the new tax code, coming into force in 2025, will not particularly affect the merger process or tax liabilities of AIX and KASE. He states that despite legal complexities, if shareholders desire the merger, it is theoretically possible.

In summary, Andey Kudyarov's responses indicate a cautious approach, highlighting uncertainties and complexities surrounding the stock exchanges merger, particularly regarding legal frameworks, tax implications and investor considerations. Moreover, his response aligns most closely with the hypothesis H1: KASE is the acquirer, and AIX is the target. He suggests that it's more likely for one exchange to migrate to the other, indicating a scenario where KASE acquire AIX. However, he also mentions the possibility of the reverse, although less likely. While he does not outright dismiss the hypothesis H2: AIX will acquire KASE, he does not express a strong preference for AIX acquiring KASE. He emphasizes the need for analyzing the tasks, overlaps of both exchanges to determine the implications of the merger, indicating that either scenario is possible.

SWOT analysis

In this section, the SWOT analysis (Strengths, Weaknesses, Opportunities, and Threats) will serve as a guiding tool for assessing the strategic implications of the KASE and AIX merger. It will provide a structured approach delving into the internal strengths and weaknesses of the merged entity and explore external opportunities and threats that could influence the success and sustainability of the merger. Through this comprehensive evaluation, the study aims to contribute valuable insights into the strategic planning and execution of this landmark merger in Kazakhstan's financial market history.

Strengths:

The merger of KASE and AIX presents several strengths that could significantly enhance Kazakhstan's capital market. By combining the resources and expertise of both exchanges, there is a potential of unified structure a more robust and liquid market. This single, unified market would bolster the country's financial infrastructure, providing better investment opportunities, trading conditions and making it more appealing to investors, both domestic and foreign. Creating a single exchange simplifies investor market access and trading processes by reducing the complexity and transaction costs associated with navigating multiple platforms. As a result, it may lead to increased trading volumes and liquidity.

Another key critical strength of the merger is operational efficiency and coordination. Through consolidation under a single management and regulatory framework, the merged exchange can realize cost efficiencies and better risk management. This streamlined operation not only reduces redundancy but also enables the implementation of coherent strategies and policies. Moreover, the merger, combined with the AIFC's international positioning, could help establish Kazakhstan as a significant player in the regional financial landscape. This strategic positioning can increase the country's visibility and influence in the regional financial ecosystem, potentially leading to greater financial flows and economic opportunities. Improved transparency and corporate governance are also anticipated benefits. The merged entity may adopt best practices in corporate governance and market regulation, thereby enhancing investor confidence and maintain long-term relationships.

Weaknesses:

The merger is not without its challenges and weaknesses. Integrating the different trading platforms, listing rules and market segments of KASE and AIX might be a bit complex and technically challenging task. The transition period during the merger could see disruptions in market operations, potentially having a negative impact on investor confidence and overall market stability. Additionally, considering the fact that KASE operates under the jurisdiction of the National Bank and the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market, while AIX operates under the AIFC regulatory framework, reconciling these distinct regulatory environments and jurisdictions adds a layer of legal and jurisdictional complexity.

Another notable weakness is the risk of losing the unique value propositions and competitive advantages that each exchange currently offers. KASE and AIX target different investor segments and issuers, offering specialized services tailored to niche markets (for example, AIFC tax benefits that was mentioned previously). Combining them could diminish the distinct offerings that attract specific market participants, potentially reducing market diversity and choice. This diversity in offerings could be compromised by the merger, impacting investors and issuers who benefit from the specialized services of each exchange.

Moreover, resistance from entrenched interests poses another challenge. Various stakeholders, such as market participants and regulators may resist the merger due to concerns about losing influence or facing operational changes. Overcoming this resistance requires extensive coordination and consensus-building efforts to align the interests of all parties involved.

Opportunities:

The presence of the possibility of re-domiciliation only in the AIFC jurisdiction under English law significantly attracts foreign players to change geolocation without suspending their main activities. When merging exchanges, this procedure will attract foreign players, but already. Moreover, Polymetal's past re-domiciliation process resulted in a significant increase in the AIX Index, liquidity and market cap. Thus, This primary and only experience of the re-domiciliation process can make a significant contribution to the development of Kazakhstani legislation within the framework of the concept of re-domiciliation, which will also entail the improvement of financial law and the possible creation of a financial code.

Treats:

One of the risks both during the merger of local exchanges and with regards to the current functional activities of the Kazakhstan Stock Exchange (KASE) is the sanctions risks associated with the composition of shareholders represented by the Moscow Exchange. The following risks and restrictions are considered: sanctions, reputation, risk of decreased liquidity. Sanction restrictions on financial transactions include possible freezing of assets and accounts belonging to the Moscow Exchange or KASE, which may subsequently significantly limit operating activities and liquidity. A similar experience was also observed with the previous suspension of trading in securities of Russian issuers. One of the major cases is also the exclusion of ordinary shares of Yandex from the official KASE list. Reputational risks may negatively affect the perception of KASE by international investors and partners, which may reduce their desire to cooperate or invest. Finally, liquidity risk includes in this case external factors. Political stability and geopolitical events can have a significant impact on market liquidity, creating conditions for changes in supply and demand. Thus, sanctions may affect liquidity on the exchange, as foreign participants may refuse to work on a platform associated with a sanctioned country.

Conclusion

To sum up, the aim of this thesis was to investigate the effects of merging the Kazakhstan Stock Exchange and Astana International Exchange on market efficiency and liquidity. regulatory framework, economics and business development success and recommendations. The potential risks, benefits and consequences of the merger were examined, considering the unique aspects of the stock exchanges being based in different jurisdictions, having a significant difference in the number of instruments and being subordinate to different regulators. At the moment, it is too early to conclude about possible outcones of the merger of stock exchanges, however, in our research it was possible to identify hypothesis through interviews. Secondary data was analysed by case study and SWOT analysis in order to reach the purpose of the research and fulfill the picture of problem in other countries regarding merger.

After reviewing the interviews of all participants, it is clear that all four hypotheses can be expected to be fulfilled if a number of factors such as organizational structure, tax policy, regulatory jurisdiction and others are taken into account. One of our participants was chosen to be financial analyst, Andrey Chebotarev, because of his deep knowledge in the field of finance. He confirmed the possibility of H3 and H4 coming up with idea of destruction of one of the exchanges to create a single holding company with single corporate center. The second participant, Assylbek Tanashikov who is one of the MNU professors contributed to research by sharing his opinion on this thesis. From his perspective it is more realistic to expect of realizing H2 and H3. The reason for this is that each side will protect their structural preferences in order to minimize employee reduction and it seems unneeded to totally destroy one of the sides. In any other way, both KASE and AIX have an organizational structure and their own list of instruments and derivatives, that is why there are more expectations of acquisitions. From this point, Mr. Tanashikov stays for “AIX will acquire KASE”. The explanation for this is the fact that the jurisdiction of AIX is more applicable for foreign investors and in order to attract them it is clear to lean on protection from English law. On the other hand, the third participant, Andrey Kudyarov, who is another professor from MNU and the one with in-depth knowledge in tax sphere, shares a different take for this case. He mostly relies to H1: KASE is the acquirer, and AIX is the target. The reason for this is his discussion regarding legal frameworks, tax implications and investor considerations, since this merger raises some uncertainty and complexity of regulatory structure.

Continuing with SWOT analysis, it revealed several key insights. The merger’s strengths include enhancing market resilience, stability and creating more liquid market, operational efficiency (enhanced optimizing processes, workflows) and cost savings, improved transparency and corporate governance and a stronger regional positioning. However, weaknesses such as challenges in technical integration, regulatory framework reconciliation, potential loss of unique value propositions and stakeholder resistance were also identified. It can be said that the possibility of redomiciliation under English law in the AIFC as part of a merger opens up new opportunities for the economy of Kazakhstan and the development of the legal framework. This experience, including the Polymetal case, can significantly improve the attractiveness of exchanges by increasing the trading volume, the diversity of participants, which together determines the level of liquidity. Finally, external factors, namely political instability and geopolitical events and the possible sanctions regime of one of the shareholders of the Kazakhstan Stock Exchange can have a significant impact on the market performance.

Overall, this research shows several points regarding possible consequences of AIX and KASE merger. Firstly, it is recommended to create a common appropriate regulatory and legal framework, along with setting up the institution of a Central Depository and a unified clearing center, which would be able to serve the united platform as one of the experts, Andrey Chebotarev, suggests the conception of a single holding company for exchanges with a single center for making corporate decisions. Secondly, it is important to note the role of investors in this situation, as one of the original goals of the merger of the stock exchanges was to attract foreign investors. For them in turn it is important to feel protected, as one of the experts, Andrey Kudyarov, noted that many civil law issues in Kazakhstan are not conducive to investor protection. Thus, there is a need of applicable tax implications and investor considerations to promote final result of merger and increase market liquidity in Kazakhstan.

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Appendix

Interview questions:

For Andrey Chebotarev:

1. How do you look at the prospect of merging domestic exchanges?
2. The key goal of uniting exchanges under a single management is to increase the capacity and attractiveness of the domestic market, since in many ways they duplicate and sometimes even copy each other. Is it really? What other factors and reasons for consolidation do you think exist?
3. What risks or opportunities might a stock exchange merger have on current shareholders?
4. Is it possible as one of the options for combining local exchanges based on Shanghai-Hong Kong Stock Connect experience?

For Assylbek Tanashikov:

1. What is your initiative to merge the exchanges?
2. What is his point of view on the closure (takeover) of any segment of stock markets and which of the takeover scenarios is more likely?
3. What risks could arise when closing one of the funds
4. What is the most favorable and, in your opinion, optimal scenario of merger of Kazakhstan stock exchanges for the next year?
5. Do you think this merger can lead to a new unit, i.e. a new entity in the market?
6. Would it have been possible to foresee the merger?

For Andrey Kudyarov:

1. Taking into account the difference in legal systems (KASE is in the field of legislation of Kazakhstan, AIFC - in English law, in a special jurisdiction created for it), what, in your opinion, is

the probability of creating an appropriate legal framework and what measures will need to be taken to ensure a smooth transition?

2. How much do you agree with such a scenario where KASE acquires AIX and the market would be entirely under domestic jurisdiction and regulation?
3. How do you think the tax benefits under the AIFC Act, in particular the exemption of interest and dividends from CIT, affect the decision-making process of investors considering holding AIX-listed securities and what are the implications if these securities are delisted and subjected to the standard provisions of the Tax Code?
4. What are the tax risks in the event that the entire stock market moves to the jurisdiction of the AIFC and in general when stock exchanges merge?
5. What do you think, if the merger of stock exchanges will be extended until 2025 and given that the new Tax Code, which will also come into force in 2025, will the Tax Code in this case affect the tax liabilities of stock exchanges AIX and KASE in the process of merger?