RISK MANAGEMENT POLICY AND INTERNAL CONTROL SYSTEM

STRENGTHENING
A SENSE OF
HOMELAND

Risk Management Policy and Internal Control System

The Bank's internal control system is formed in accordance with the requirements of the laws of the Republic of Kazakhstan, the Basel Committee on Banking Supervision and best international practices. The Bank applies the concept of the Integrated COSO Model developed in 2013 to build its internal control system. The Bank's Internal Control System (hereinafter, the ICS) is a process embedded in the day-to-day activities performed by the Board of Directors, collegial bodies, structural units and all employees of the Bank in the performance of their duties.

The Board of Directors of the Bank and the Risk Management and Internal Control Committee monitor the Bank's activities in order to identify and eliminate internal control deficiencies, violations and errors. On a quarterly basis, the Bank's Board of Directors and the Risk Management and Internal Control Committee review reports on operational risks, information technology and information security risks and internal control risks and make relevant decisions. In addition, the Board of Directors reviews and approves key internal documents regulating ICS in the Bank.

The Bank's ICS is multilevel and includes all units of the Bank. Participants of the internal control process are defined on the basis of three lines of defense.

The first line of defense is provided by all structural units of the Bank and represents controls designed to ensure correct execution of daily operations in the processes. Controls are developed by business units and are an integral part of business processes to minimize risks and comply with the requirements of internal documents, as well as to comply with external, regulatory requirements. Controls are managed and monitored by the business units themselves, which implies the ability of business units to identify risks, weaknesses in business processes, possible unforeseen events and respond to them in a timely manner.

The second line of defense is provided by the Internal Control Unit that monitors, coordinates and documents ICS, and units that ensure identification and assessment of risks in certain areas of the Bank's activities, including Risk Management Unit, Chief Compliance Officer and Compliance Control Unit, Situational Monitoring Unit, Human Resources Unit, Legal Unit, Security Unit, Information Security Unit, Information Technology Risk Management Unit.

The third line of defense is provided by the Internal Audit Unit in the form of an independent assessment of the effectiveness of the Bank's ICS using the results of audits or in the form of a separate assessment of ICS effectiveness.

The Internal Control Unit provides consulting assistance to the Bank's employees on internal control issues in accordance with the Bank's internal regulatory documents, the regulatory documents of Baiterek NMH JSC, the regulatory documents of the National Bank of the Republic of Kazakhstan and the laws of the Republic of Kazakhstan in order to ensure the effective functioning of the ICS in the Bank. Every year, the Internal Control Unit conducts internal training of all Bank employees on the internal control system, followed by testing.

As part of the ICS monitoring and documentation activities, the Internal Control Unit conducts random audits of the Bank's business processes in accordance with the work plan/on behalf of the management, including diagnostics of the adequacy of the design of internal controls preventing or detecting identified risks in the processes. In 2023, the Unit performed diagnostics/audits of three processes, including:

- Sale of housing through the HCS system at the expense of the Bank's own funds/mixed funds/organizations' funds;
- Sale of housing through the HCS system at the expense of attracted budgetary funds/funds of local executive bodies;
- Personnel Management (audit of job descriptions of managers for the presence of functionality and responsibility for internal control).

Based on the results of diagnostics, the following findings were identified in the processes: the need for process optimization, regulation of control procedures, the presence of controls with partially effective design, the presence of a significant share of manual controls in the processes.

In order to minimize the consequences of the findings and controls with partially effective design, recommendations to process owners were developed, including recommendations to eliminate violations, improve the regulation/automation/optimization of processes.

The Bank's Risk Management Committee reviewed/will review reports on the audits conducted, approved/will approve corrective action plans to eliminate identified deficiencies, containing 47 corrective actions. Responsible structural units of the Bank work on elimination of violations and implementation of corrective action plans.

Structural units – participants of all lines of defense – business process owners on an annual basis identify risks in their processes and self-assess the adequacy of the design of internal controls mitigating the identified risks. The results of the self-assessment are presented in the Bank's Matrix of Business Processes, Risks and Controls (hereinafter, the Matrix). The Matrix for the forthcoming reporting year, containing self-assessment of business process owners/assessment of the internal control unit, is updated by process owners with the coordination and methodological support of the internal control unit and approved annually by the Board of Directors. If necessary, business process owners develop and the Management Board approves action plans to eliminate deficiencies/ineffectiveness of internal control in the processes. Further monitoring of the implementation of corrective action plans for internal control is performed by the internal control unit on a quarterly basis, with submission of progress information to the Risk Management Committee/the Management Board of the Bank.

Risk Management

In accordance with the Bank's Risk Management Policy, the Bank's Board of Directors ensures that a risk management system is in place that is appropriate to the selected business model, scale of operations, types and complexity of operations, and ensures an appropriate process for identifying, measuring and assessing, monitoring, controlling and minimizing significant risks to ensure the Bank's financial stability and stable functioning.

A key factor of the Bank's high risk management culture is regular communication of risk-related issues, including risk management policies and procedures, to the Bank's authorized collegial bodies, including the Board of Directors of the Bank. The exclusive competence of the Bank's Board of Directors in terms of risk management includes the powers regulated by the Articles of the Bank, internal documents of the Bank, as well as the Regulations on the Bank's Board of Directors. The Bank's Board of Directors monitors and controls risk management, internal audit, compliance with the requirements of the laws of the Republic of Kazakhstan and internal documents of the Bank through interaction with authorized collegial bodies under the Bank's Board of Directors, the Bank's Management Board and the Head of Risk Management in order to effectively perform their duties. The Risk Management Committee of the Bank's Board of Directors operates within the framework of the Regulations defining its powers, competence and principles of its work. The Risk Management Committee of the Bank's Board of Directors regularly receives data and reports from risk management and other responsible departments on the Bank's current risk level, risk appetite levels and risk mitigation mechanisms, as appropriate.

The Bank's Board of Directors has developed and approved the Bank's Risk Appetite Strategy, which defines clear limits on the volume of accepted risks inherent in the Bank's activities within the framework of the implementation of the Bank's general strategy, as well as defines the risk profile of the Bank's activities in order to prevent the implementation of risks or minimize their negative impact on the Bank's financial position.

In accordance with the Risk Appetite Strategy, the Bank's Board of Directors approves the Bank's Risk Appetite Statement. As part of the Risk Appetite Statement, a set of quantitative and qualitative indicators of risk appetite levels is approved for each material risk of the Bank, taking into account the Bank's business model. Compliance with risk appetite levels in accordance with the Bank's Risk Appetite Statement is monitored on a periodic basis and information on the results is submitted to the Bank's authorized bodies, including the Bank's Board of Directors, as part of risk management reporting.

The main financial risks inherent to the Bank's operations are market risk (currency risk, interest rate risk), liquidity risk and credit risk.

Information on compliance with aggregated risk appetite levels as at 01.01.2024 (in KZT million)

Risk name	Risk appetite level as at 01.01.24	Approved risk appetite level for 2023	Adequacy of risk appetite level
1	2	3	4 = 3 – 2
Credit risk	**6,414**	**117,989**	**111,575**
loan portfolio	5,402	80,863	75,461
interbank deposits	158	32,140	31,982
non-government securities	853	4,986	4,132
Market risk	**13,771**	**32,293**	**18,521**
Interest rate	13,768	29,689	15,922
Currency	1	2,577	2,576
Price	2	26	24
Liquidity risk	6,951	24,462	17,511
Aggregate risk level	**27,137**	**174,744**	**147,607**

The current aggregate level of credit, market and liquidity risk as at 01.01.2024 is KZT 27 billion and is within the approved risk appetite level, which is 16% of the approved risk appetite level for 2023.

For the purposes of capital adequacy assessment, the Bank has developed and implemented the Regulation on Internal Capital Adequacy Assessment Process (ICAAP) approved by the Board of Directors of the Bank. As part of the ICAAP, the Bank identifies, assesses and controls significant risks inherent in the Bank's operations and plans capital based on the Bank's strategy, the results of a comprehensive assessment of significant risks, stress testing of the Bank's financial stability in relation to internal and external risk factors, and the Bank's capital adequacy requirements.

Assessment of the impact of the Bank's current risks* on the level of equity capital adequacy

Regulator standard	Actual as at 01.01.24	Subject to current risk level	Deviations from actual
1	2	3	4 = 3 – 2
k1 (min. 0,055)	0,348	0,332	-0,016
k1-2 (min. 0,065)	0,348	0,332	-0,016
k2 (min. 0,080)	0,348	0,332	-0,016

**credit, market and liquidity risk*

Capital adequacy, taking into account the current aggregate risk level, will decrease by –0.016 on all coefficients, however, its value will be higher than the minimum requirements set by the regulator due to a significant amount of equity capital (KZT 588 billion).

Currency risk. The Bank's exposure to currency risk is minimal given the specific nature of the Bank's business model. The Bank does not conduct transactions with foreign currency, except for the purchase of foreign currency in fulfilment of obligations under administrative and business contracts.

Interest rate risk. The Bank's interest rate risk represents the risk of losses due to unfavorable changes in interest rates.

As part of interest rate risk management, the Bank analyses sensitive assets and liabilities whose yield and value are determined by interest rate. To control interest rate risk exposure, the Bank uses interest rate gap analysis tool, the purpose of which is to determine over which time interval the exposure to interest rate risk arises due to changes in interest rates.

Liquidity risk. For the purposes of liquidity adequacy assessment, the Bank has developed and implemented the Regulation on Internal Liquidity Adequacy Assessment Process (ILAAP) approved by the Board of Directors of the Bank. As part of the ILAAP, the Bank has an effective process for identifying, assessing, monitoring and controlling liquidity risk, which includes forecasting cash flows on assets, liabilities and off-balance sheet instruments for different time intervals. The Bank assesses all balance sheet and off-balance sheet items affecting the level of liquidity risk, as well as the level of liquidity in the market to cover the Bank's need to raise funding to regulate liquidity risk, if necessary.

Taking into account the specifics of the Bank's business model, the Bank's stable funding base consists primarily of budget funds within the framework of state programs to provide the population with affordable housing and housing construction savings.

As part of the ILAAP, the Bank's exposure to liquidity risk is assessed in case of mismatch between the maturity of asset and liability liabilities, as well as inadequate liquid assets and funding sources, including taking into account the situation on the financial market.

The main objective of the Bank's liquidity risk management is to determine the methods of assessment and procedures for maintaining adequate liquidity level. The Bank's liquidity risk is managed by analyzing the level of liquid assets required to settle liabilities as they fall due, ensuring access to various sources of funding, having contingency plans in place in case of funding problems and monitoring liquidity ratios in accordance with the level of liquidity risk appetite and the regulator's prudential liquidity requirements.

The main measures to minimize liquidity risk, taking into account the specifics of the Bank's business model:

- monitoring compliance with the limits set by the regulator and the Bank's internal limits on liquidity risk;
- control of the Bank's daily (intraday) liquidity position;
- conducting a gap analysis of the Bank's assets and liabilities by maturity, the purpose of which is to determine the time interval over which the Bank is exposed to liquidity risk and to assess the impact of the liquidity imbalance in a certain time interval on the Bank's ability to meet its obligations;
- regular stress testing of liquidity risk under various scenarios.

The table below shows the liquidity gap as at 01.01.2024 (in KZT million)

	On demand	[0-7d]	[от 1н до 1м]	[от 1m-3m]	[3m-6m]	[6m-12m]	[1y-2y]	[2y-3y]	[>3y]	Total balance sheet
Assets	174 716	170 142	313 805	144 918	48 720	106,636	229 821	272 941	2,534,334	3 996,034
Liabilities	284 703	14 089	62 329	90 241	38 311	155 943	224 111	154 791	2 376 875	3 401 392
Contingent liabilities			3 664	7 328	10 991	14 655				36,638
GAP	–109 986	156 054	247 813	47 350	–582	–63 962	5 709	118 150	157 459	558 005
Cumulative GAP	–109 986	46 068	293 880	341,230	340 648	276 686	282 395	400 546	558 005	
Cumulative GAP /Assets		1,20%	7,40%	8,50%	8,50%	6,90%	7,10%	10,00%	14.0%	

The following assumptions were used to calculate the liquidity gap:

- all assets and liabilities are distributed over time intervals depending on the maturity dates;
- contingent liabilities are distributed on the basis of housing loans disbursed per month (excluding previously disbursed preliminary and bridging loans).

The resulting negative gaps in the net gap are due to the increase in accumulated customer accounts on demand deposits of KZT 230 billion mainly due to the funds of legal entities on current accounts, as well as on maturities '91 to 180 days' and '181 days to 1 year' of KZT 37 billion and KZT 152 billion mainly due to deposit balances in these periods.

At the same time, the cumulative liquidity gap for all maturities is positive, except for demand loans. The minimum value of the ratio of cumulative liquidity gap to total assets falls on the term 'up to 7 days' and amounts to 1.2%. The Bank complies with the approved internal limits on cumulative gap in the amount of not less than 2% of the Bank's assets.

CREDIT RISKS

The following activities were carried out as part of the Decision-Making System:

new scoring cards for preliminary and bridging loans were developed and implemented;

scoring population stability reporting (PSI) was implemented;

customer segmentation according to the EI (estimated indicator) was implemented.

At the end of 2023, the share of provisions created in accordance with IFRS was 0.17% of the loan portfolio, while the share of the Bank's 20 large loans was 0.06% of the Bank's loan portfolio, indicating that there is no risk of loan portfolio concentration. In the structure of collateral, the share of real estate was 84.00% of the total collateral. The overall weighted average L/C (loan/collateral) ratio was 40.18%, which indicates a conservative collateral policy.

For comparison, at the end of 2022, the share of provisions created in accordance with IFRS was 0.20% of the loan portfolio, while the share of the Bank's 20 large loans was 0.07% of the Bank's loan portfolio, indicating that there is no risk of loan portfolio concentration. In the structure of collateral, the share of real estate was 81.04% of the total collateral. The overall weighted average L/C (loan/collateral) ratio was 40.93%, which indicates a conservative collateral policy.

OPERATIONAL RISKS

The Bank's operational risk management system (ORMS) is established in accordance with the requirements of the laws of the Republic of Kazakhstan, recommendations of the Basel Committee on Banking Supervision, generally accepted principles and banking practices of risk management, as well as generally accepted international practices.

The Bank's ORMS infrastructure includes:

1. identification of operational risks: analyzing both existing and implemented internal procedures and systems, as well as products and services provided by the Bank;
2. assessment of operational risks: measurement of operational risks in order to determine trends in the level of their changes;
3. strategic management of operational risks: development of principles of continuous operational risk management in the Bank;
4. continuous management of operational risks: carried out by all structural units of the Bank and includes reduction of the level of exposure to operational risk and elimination of negative impacts of operational risk events in all structural units of the Bank;
5. monitoring and reporting on operational risks: monitoring of the level of operational risk and compliance with the level of operational risk appetite is performed by the Bank on a regular basis. To monitor operational risk, the Bank uses a management reporting system for management and collegial bodies involved in risk management processes, regular assessment of risks affecting the achievement of its objectives, changing circumstances and conditions, and development of risk management recommendations. Management reporting information is provided to the Board of Directors / Management Board of the Bank on a quarterly/monthly basis;
6. prevention/mitigation (control): a set of measures aimed at preventing/reducing the probability of occurrence of events or circumstances leading to operational losses or at reducing the size of potential losses.

In 2023, measures were taken to improve the database for collecting and analyzing internal data on operational risk events.

INFORMATION SECURITY AND INFORMATION TECHNOLOGY RISK MANAGEMENT

To ensure effective functioning of information security and information technology (hereinafter, the IS and IT) risk management systems, in accordance with the requirements of the laws of the Republic of Kazakhstan, the following documents have been developed and kept up to date:

1. IT and IS Risk Management Policies;
2. IT Risk Management Rules;
3. IS Risk Assessment Methodology;
4. Methodology for Determining Potential Loss on Information Security Risks;
5. Methodology for Determining Risk Appetite Benchmarks for IS and IT Risks at Otbasy Bank JSC.

In 2023, the working group for forming the list of critical information assets under the supervision of the Internal Control Unit classified the Bank's information assets and approved the list of the Bank's critical information assets.

In 2023, the responsible units of the Bank assessed the level of IS and IT risks. The results of risk assessment as part of the report on IS and IT risks were presented to the Management of the Bank.

The Internal Control Unit provides periodic reports on IT and IS risks to the Information Security Committee, the Management Board and the Board of Directors of the Bank.

BUSINESS CONTINUITY MANAGEMENT

The Bank's business continuity management is aimed at ensuring the Bank's resilience to any incidents by eliminating or minimizing downtime and quickly recovering key business processes and minimizing losses. For these purposes, the following have been developed, approved and kept up to date:

- the Bank's Business Continuity Management Policy;
- the Bank's Business Continuity Management Rules;
- the Bank's Business Continuity Plans by Business Lines.
- The following activities are carried out annually in this area:
- training of the Bank's personnel on business continuity issues;
- analyzing the impact on operations of the Bank's critical processes and business lines;
- testing and analyzing the Bank's business continuity plans;
- analyzing the risks of unforeseen circumstances for which a risk response action plan has been drawn up.

COMPLIANCE RISK

In a broad sense, compliance control is a system of management and control in an organization related to the risks of non-compliance with legislative requirements, regulations, rules and standards of supervisory authorities, codes of conduct, and other regulatory documentation of the organization.

Compliance control is an integral part of the internal control function, the purpose of which is to protect the interests of investors, banks and their customers by controlling compliance by the Bank's employees with legislative provisions, requirements of supervisory authorities, internal documents of the Bank regulating the Bank's services and operations in the financial market.

An effective compliance risk management system and its maintenance allow management to identify in a timely manner all significant risks of incomplete implementation of the Bank's business goals.

Responsibility for compliance is based on the Bank's compliance culture, which is reflected in the Bank's 3 lines of defense:

1. The first line of defense manages compliance risk within its competence and in accordance with the Bank's internal documents on compliance risk management (first level control). The participants are the Bank's employees and the heads of the Bank's structural units;
2. The second line of defense is compliance risk management and compliance control (second level control). The participants are the Chief Compliance Officer and the Compliance Control Unit;
3. The third line of defense is an independent assessment of the effectiveness of the compliance risk management system (third level control). The participant is the Internal Audit Unit.

All participants of the compliance risk management system, within their competence and responsibility, manage compliance risks in strict and rigorous compliance with the requirements of the laws of the Republic of Kazakhstan, the laws of foreign countries affecting the Bank's operations and recognized by the Republic of Kazakhstan, the Bank's internal rules and procedures, as well as generally accepted codes of conduct.

The main objective of compliance risk management is to minimize and/or maintain at an acceptable level compliance risks, such as financial losses incurred by the Bank and application of legal sanctions to the Bank due to non-compliance with the requirements of the laws of the Republic of Kazakhstan, regulations of the competent authority, internal documents and procedures of the Bank, as well as the laws of foreign countries affecting the Bank's operations and recognized by the Republic of Kazakhstan.

To effectively manage compliance risks, the Compliance Control Unit identifies and assesses their causes:

- data on compliance risks are collected and analyzed on a regular basis. The results of audits and a unified internal database of operational losses and events are used for this purpose;
- the Compliance Control Unit is involved in the introduction of new products and services;
- internal audits of the Bank's internal documents and processes for compliance with the laws of the Republic of Kazakhstan are conducted on a regular basis (5 audits were conducted by the Compliance Control Unit in 2022);

- the Know Your Customer principle has been implemented;
- a compliance risk register is maintained and a compliance risk map is drawn up;
- training workshops are conducted in the Bank as part of strengthening compliance culture.

To ensure compliance of the Bank's activities with the laws of the Republic of Kazakhstan, the Compliance Control Unit continuously monitors amendments to the laws of the Republic of Kazakhstan and provides further recommendations on the development of new internal documents and introduction of relevant amendments to the Bank's internal documents and procedures.

The Bank has a financial monitoring system in place to fulfil the requirements of the laws on anti-money laundering and counter-terrorism financing (hereinafter, the AML/CFT).

The main purpose of the financial monitoring system is to minimize the risks arising from banking transactions subject to financial monitoring and other transactions with money or property related to money laundering, terrorism financing and financing of proliferation of weapons of mass destruction by ensuring compliance with the requirements of the AML/CFT laws of the Republic of Kazakhstan, preventing the Bank's involvement in money or property related to money laundering, terrorism financing and financing of proliferation of weapons of mass destruction, maintaining the effectiveness of the Bank's internal control system at a level sufficient to manage the risks.

The Bank implements the Know Your Customer principle, conducts due diligence procedures when establishing business relations, ensures completeness and timeliness of submission of information on transactions subject to financial monitoring to the competent financial monitoring authority

ESG RISKS

Along with credit, market, strategic, operational, compliance, liquidity, information security and IT risks, the Bank's Risk Register includes a separate group of ESG risks. ESG risks are identified taking into account the expectations of investors, staff and other stakeholders of the Bank. To take into account all possible consequences of the Bank's activities, the following is analyzed on a periodic basis:

- the needs of stakeholders;
- potential conflicts that may jeopardize projects or arise at various stages of their implementation;
- opportunities and relationships that may arise in the course of implementation of the Bank's projects.

Based on an analysis of external and internal factors, the Bank has compiled a detailed list of ESG risks, which cover environmental, corporate governance, health and safety and human rights.

ESG risks in the Risk Register are subdivided into:

1. environmental risks: non-compliance of the Bank, its authorized bodies and employees with the requirements of the environmental laws of the Republic of Kazakhstan;
2. social and labor risks: violation by the Bank of labor laws in terms of occupational health and safety, resulting in temporary or permanent disability of an employee, non-observance by the Bank of the rights and legitimate interests of employees, violation of working hours and rest periods, lack of staff motivation, lack of indexation of remuneration, low level of employee involvement, lack of professional development programs;
3. corporate governance risks: reduction of supervision by the Bank's Board of Directors over the efficiency of the internal control system.

The final rating of this type of risk is assessed as low.

CLIMATE RISKS

In light of the growing concern about climate change, the Bank intends to integrate environmental and global climate change risks into its risk management system.

The Bank's portfolio already includes loans to purchase a home in a property that meets the green standard, which now forms the basis of goal-setting to reduce the impact on global climate change. Based on an assessment of climate risks and opportunities, the Bank plans to develop processes to manage these risks in its housing loan portfolio, and to include risk mitigation activities such as setting financing criteria, supporting customers in improving energy efficiency or developing renewable energy sources.

The Bank will work to identify climate risks of the Republic of Kazakhstan (from extreme weather, flood, fire and other climatic factors) and assess the level of their impact throughout the Republic of Kazakhstan in 2024.

These activities will enable the Bank to take climate change and other environmental risks into account when originating mortgage loans and provide a more reliable and sustainable approach to credit underwriting.