



REPUBLIC OF KAZAKHSTAN

FINANCIAL SECTOR ASSESSMENT PROGRAM

DETAILED ASSESSMENT OF OBSERVANCE—BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

February 2024

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision for the Republic of Kazakhstan Financial Sector Assessment Program was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in January 2024.

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DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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This report was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Kazakhstan during March-April 2023, led by Pierpaolo Grippa, IMF and Pietro Calice, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance, Competitiveness and Innovation Global Practice, World Bank. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>, and www.worldbank.org/fsap.



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Glossary

AC	Additional Criterion
ACF	Analysis of Credit Files
AFSA	Astana Financial Service Authority
AI	Artificial Intelligence
AIFC	Astana International Financial Center
AMC	Asset Management Company
AML-CFT	Anti-Money Laundering / Combating the Financing of Terrorism and Financing of Proliferation of Weapons of Mass Destruction
AQR	Asset Quality Review
ARDFM	Agency of the Republic of Kazakhstan for the Regulation and Development of the Financial Market
BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles
BIA	Basic Indicator Approach
BL 2444	Law on Banks and Banking Activity in the Republic of Kazakhstan
CCB	Capital Conservation Buffer
CDD	Customer Due Diligence
CP	Core Principle
CRO	Chief Risk Officer
Decree n. 203	Decree № 203 of the President of the Republic of Kazakhstan as of 11 November 2019 On further improvement of the public administration system of the Republic of Kazakhstan
D-SIB	Domestically Systemic Important Banks
EAD	Exposure at default
EC	Essential Criterion
ECL	Expected credit losses
EVE	Economic value of equity
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSA	Financial Stability Assessment
FSC	Financial Stability Council
FX	Foreign Exchange
GDP	Gross Domestic Product
HQLA	High Quality Liquid Assets

HR	Human Resources
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commission
IRRBB	Interest Rate Risk in the Banking Book
JSC	Join Stock Company Act – Law n. 415/2003
KDIF	Kazakhstan Deposit Insurance Fund
KPI	Key Performance Indicator
KZT	Kazakhstan Tenge
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LoLR	Lender of Last Resort
MDBs	Multilateral Development Banks
MFI	Micro-Financial Institutions
ML	Money Laundering
MMOU	IOSCO’s Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information
MOU	Memorandum of Understanding
NBFI	Non bank financial intermediaries
NBK	National Bank of Kazakhstan
NII	Net Interest Income
NPA	Non-Performing Assets
NPL	Non-Performing Loan
NSFR	Net Stable Funding Ratio
OECD	Organization for Economic Cooperation and Development
PD	Probability of Default
RAS	Risk Assessment System
RBA	Risk Based Approach
RORWA	Return on Risk-Weighted Assets
RWA	Risk Weight Assets
SICR	Significant Increase of Credit Risk
SME	Small and Medium Enterprises

SREP	Supervisory Review Examination Process
SWOT	Strengths, Weaknesses, Opportunities, Threats
TA	Technical Assistance
UTP	Unlikely to Pay
WB	World Bank

EXECUTIVE SUMMARY

At the end of 2019 the financial sector supervisory responsibilities of the National Bank of Kazakhstan (NBK) were transferred to the newly established authorized body Agency of the Republic of Kazakhstan for the Regulation and Development of the Financial Market (ARDFM). ARDFM has made progress in delivering on its supervisory mandate by conducting stress test and internal desk-based assets quality review (AQR), which became two annual exercises that complement the supervisory review examination process (SREP). However, the most recent transfer of the supervisory function has represented a setback in terms of mandate and budget.

Along with the financial stability mandate, the ARDFM pursues a development objective, including by supporting the expansion of banks' loans portfolio, which can conflict with the safety and soundness of banks and the banking system, and it is not subordinate to it. The ARDFM independence is not prescribed in the legislation, but rather undermined by several provisions in the Law 474-II which makes the ARDFM 'directly subordinated' to the President of the Republic of Kazakhstan who approves the organization structure and the staff. Moreover, the ARDFM is funded only from the republican budget.

ARDFM began its activities during the coronavirus pandemic. It took various measures to mitigate the impact of Covid-19 on the economy, including enacting regulatory forbearance measures to release banks' capital and liquidity and encourage banks to restructure loans. In 2020, to mitigate the effects of the crisis on the Kazakhstan's economy, the ARDFM, in cooperation with the Government and NBK, implemented a wide range of anti-crisis measures. Regulatory forbearance measures released banks' capital and liquidity and encouraged banks to restructure loans. ARDFM reduced risk-weighting ratios when calculating capital adequacy on small and medium enterprises (from 75 percent to 50 percent), loans in foreign currency (from 200 percent to 100 percent), and syndicated loans (from 100 percent to 50 percent). To stem tensions in the FX market, ARDFM reduced the limits to long foreign exchange position (from 12.5 percent to 7.5 percent of capital) and total foreign currency net position (from 25 percent to 12.5 percent of capital). The ARDFM has temporarily reduced the capital conservation buffer (from 2 percent to 1 percent) and the liquidity coverage ratio (LCR) from 0.8 to 0.6 (March 30, 2020, to April 1, 2021); it postponed the tightening of the net stable funding ratio (NSFR). ARDFM also relaxed provisioning requirements for small and medium-sized enterprises (SMEs) restructured loans, by excluding the restructuring factor from the criteria for automatic loan impairment when forming allowances. Banks provided a deferment of payments on loans to SMEs; at the choice of the borrower, the grace period ranged from 30 to 90 days. As the economic activity recovered, forbearance measures were progressively exited. By end of 2021 most of the regulatory easing was completed, except for the reduced risk-weighting ratio of loans to SMEs and syndicated loans, which were still in place at the end of the assessment. ARDFM should phase out also these remaining measures as soon as possible since they undermine the credibility in banks' capital adequacy ratios and reduce their resilience.

Geopolitical risks, including the Russian invasion of Ukraine, put pressure on the Kazakhstan's financial sector. Along with inflationary and exchange rate pressures, the spillover effects include

the need to preserve liquidity by the three subsidiaries of the Russian banks and the risk of local banks getting involved in transactions with sanctioned subjects and getting eventually hit by secondary sanctions. While NBK supported banks in need of liquidity, ARDFM had to postpone the full-fledged implementation of LCR and NSFR, which are both at 80 percent instead of 100 percent at the date of the assessment. Moreover, violation of LCR, NSFR and other liquidity ratios due to outflow of deposits, revaluation of assets and liabilities have been temporarily tolerated (from February 21, 2022, to December 31, 2022), subject to banks providing an action plan to address this violation within nine months. ARDFM should set LCR and NSFR at 100 percent as soon as feasible and work with impacted banks on a plan to restore liquidity buffers as needed.¹

ARDFM has introduced a risk-based approach (RBA), and its supervisory methodology for assessing the nature, impact, and risk of banks is based on the Risk Assessment System (RAS), which feeds into the SREP. In 2021, for the first time, the ARDFM conducted a full-scale assessment of banks using the SREP methodology, and an internal desk-based AQR and supervisory stress testing in a pilot mode. Since 2022 the ARDFM conducts regular AQR and supervisory stress-testing that covers over 70 percent of the banking sector’s assets. Also benefitting from IMF technical assistance, ARDFM is working to further enhance its RBA, namely developing a methodology for calculating Pillar 2 capital add-ons based on qualitative and quantitative parameters, as well as stress test results.

However, supervisory discretion is constrained as the law enables the ARDFM to exert its “motivated judgment” (equivalent to supervisory judgment) only in five areas (licensing, related party transactions, risk management and internal controls, provisioning, and major participants). This reduces room for discretion, which is an important ingredient of an effective RBA, including when determining capital and liquidity that banks should hold in excess of the minimum to account for risks that are not covered, or not fully covered, by the Basel Pillar 1 framework. The expansion of the reasoned supervisory judgement to new areas (for example, on concentration risk and ‘*group of connected counterparties*’), should be supported by strengthening the legal protection of staff.

Banks’ asset quality, while improving, remains a source of concern. The clean-up of the system’s non-performing loans was realized mainly through government bailouts of troubled banks by means of: (i) equity injection; (ii) issuance of subordinated debt at below market interest rates, with the resulting capital gain used to write off past-due loans; and (iii) purchase by the state-owned ‘bad’ bank, the Problem Loans Fund, of past-due exposures significantly above market price or even at 100 percent of the nominal value. With the introduction of IFRS 9 (January 2018), Kazakhstani banks transitioned from an incurred loss to an expected credit loss model. However, while the official nonperforming loan (NPL) ratio stands at about 3 percent, IFRS stage 3 loans (credit impaired) are 6.6 percent, as reported by ARDFM.

¹ ARDFM will restore LCR and NSFR at 100 percent from July 2024.

Another area of concern is related party transactions. While the reported exposure to related parties remains relatively low (2.2 percent of banks' capital), there is documental evidence of insider abuse and extrapolation of private benefits from banks that recently defaulted (e.g., on-site inspection reports). In all banks that were liquidated in recent years, de facto exposure to related parties was significantly above than that officially reported and was the main source of NPLs and reason for liquidation. The ARDFM should perform a more intrusive oversight of related party transactions, including onsite reviews. In addition, the authorities should take more stringent corrective measures vis-à-vis gaps in banks' related party framework and practices.

INTRODUCTION AND METHODOLOGY²

A. Introduction

1. This assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Kazakhstan has been completed as a part of the Financial Sector Assessment Program (FSAP) mission undertaken by the International Monetary Fund (IMF) and the World Bank (WB) during February-April 2023, at the request of the Kazakhstani authorities. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or the crisis management framework, which are addressed in other parts of the FSAP.

2. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision.³ Since January 2020 banking supervision in Kazakhstan has been conducted by the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market (ARDFM). This is the third reorganization of the supervisory authority. From 2004 to 2011 the regulatory and supervisory functions were performed by the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (FSA), an entity reporting directly to the President. Following the Global Financial Crisis, the FSA was abolished (2011) and banking supervision integrated into the NBK. Most recently, with the Decree № 203 of the President of the Republic of Kazakhstan as of 11 November 2019 (Decree 203) *on further improvement of the public administration system of the Republic of Kazakhstan*, the financial sector supervisory responsibilities of the NBK have been transferred to the newly established authorized body Agency of the Republic of Kazakhstan for the Regulation and Development of the Financial Market (ARDFM), which formally launched its operations in 2020.

3. The ARDFM chose to be assessed and rated against the essential criteria of the BCP. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) were usually the only elements on which to gauge full compliance with a Core Principle (CP). The additional criteria (AC) are recommended best practices against which the authorities of some more complex financial systems may agree to be assessed and rated.⁴ The assessment of compliance with each principle is made on a qualitative basis, using a five-part rating system explained below. The assessment of compliance with each CP requires

² The assessment team comprised F. Christopher Calabia, a former senior U.S. regulator, and Ezio Caruso, Senior Financial Sector Expert, World Bank.

³ This assessment does not cover the supervisory approach of the Astana Financial Supervisory Authority (AFSA), which oversees the supervision of the Astana International Financial Centre (AIFC), a separate jurisdiction under distinct law and courts. A different report issued as part of this FSAP covers reviews the links between the AIFC and the Kazakhstan financial system, and the implications for financial stability.

⁴ As envisaged in the BCP methodology, a country's authorities can opt for (i) being assessed and rated only on the basis of the Essential Criteria (EC), or (ii) being assessed and rated against both ECs and Additional (ACs); (iii) being assessed against ECs and ACs but rated only against ECs. The Agency was offered all three options and they expressly selected option (i).

judgment on whether the criteria are fulfilled in practice. Evidence of effective application of relevant laws and regulations is essential to confirm that the criteria are met.

4. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of ARDFM, NBK, auditing firms, and banking sector participants. The authorities provided a self-assessment of the CPs, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff, and systems.

5. The team appreciated the very high quality of cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided excellent support, including extensive provision of documentation and access, at a time when staff was burdened by many initiatives related to global regulatory changes. The team also appreciates the responsiveness of ARDFM staff to some of the assessors' findings and recommendation: after an informal presentation of the assessment's conclusions, the assessors observed how Agency staff quickly initiated work to address them in areas such as IRRBB and operational risk.

B. Methodology

6. The standards were evaluated in the context of the Kazakhstani financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions, whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions, and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, risk profile, and cross-border operation of the banks being supervised.

7. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. As noted above, reaching conclusions requires judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the authorities with an internationally consistent measure of the quality of their banking supervision in relation to the revised CPs, which are internationally acknowledged as minimum standards.

8. To determine observance of each CP, the assessment has made use of four rating categories: compliant, largely compliant, materially noncompliant, and non-compliant. A rating of "compliant" is given when all ECs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" rating is given when there are only minor shortcomings, which do not raise serious concerns about the authorities' ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented). A rating of "materially non-compliant"

applies in the case of severe shortcomings when, despite the existence of formal rules and procedures, there is evidence that supervision has not been effective, practical implementation is weak, and that the shortcomings are sufficient to raise doubts about the authorities' ability to achieve compliance. A principle is rated "non-compliant" if it is not substantially implemented, several ECs and ACs are not complied with, or supervision is manifestly ineffective. The category of "non-applicable" is reserved for those cases where the criteria are not relevant to the jurisdiction's circumstances.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

A. Institutional Structure

9. With the Decree № 203 of the President of the Republic of Kazakhstan as of November 11, 2019 (Decree 203) On further improvement of the public administration system of the Republic of Kazakhstan, the financial sector supervisory responsibilities of the NBK have been transferred to the newly established authorized body (ARDFM), which formally launched its operations in 2020. The banking supervision architecture in Kazakhstan has historically shown a high degree of variability, particularly in the wake of episodes of financial instability. From 2004 to 2011 the regulatory and supervisory functions were performed by the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (FSA), an entity reporting directly to the President. Following the Global Financial Crisis, the FSA was abolished (2011) and banking supervision integrated into NBK. Although there is no optimal organization of financial supervision (sectoral or integrated, linked to the Central Bank or separate), the lack of continuity in the institutional setup can negatively impact the supervisory function's capacity to perform its duties effectively and efficiently. Major new changes in the institutional setting of financial supervision should be a last resort.

10. The ARDFM has multiple mandates: (i) protects the rights of consumers of financial services, (ii) contributes to maintaining financial stability, (iii) regulates, supervises, and oversees financial organizations, and (iv) implements policies for the development of the financial market The development mandate, which includes the promotion of financial innovation (regulatory sandbox, open banking technology etc.), can conflict with the financial stability objective, and it is not subordinate to it. For example, one of the ARDFM's key performance indicators is the increase in total banking loan portfolio "from 2019" (20–28 percent in 2022) and "from 2021" (38 percent in 2023); targets are also set for the increase of bank loans to legal entities "from 2021" (17 percent in 2023 and 28 percent in 2024). Without clear subordination of this development mandate to the prudential one, it could be pursued at the expense of the safety and soundness of banks and banking system.

11. Although NBK "contributes to ensuring the stability of the financial system" ARDFM has not signed a Memorandum of Understanding (MOU) with the NBK. There is only an information sharing agreement.

12. In 2019, the role of the Council on Financial Stability of the Republic of Kazakhstan was strengthened (Decree of the President of the Republic of Kazakhstan № 220 of December 18, 2019). Established in 2010, the Council is an advisory and consultative body to the President of the Republic of Kazakhstan and performs now, following the institutional reform splitting NBK and the Agency, interdepartmental coordination on financial stability. The functions of the Council include preliminary consideration of issues of macroprudential policy, anti-crisis measures, resolution of systemically important banks, and financing of measures to restore the banking sector. The Council considers other issues related to ensuring financial stability and minimizing systemic risks, as well as gives recommendations based on the results of discussions.

B. Overview of the Banking Sector

13. The financial system of the Republic of Kazakhstan is bank-centered model. The main share of financial system assets is concentrated in the banking sector, which accounts for about 79 percent of financial system assets at end-2022; another 7 percent is held by the Development Bank of Kazakhstan, and the remaining 14 percent by other sectors of the financial market.

14. At the end of 2022, the banking sector is composed of 21 second-tier banks, of which 12 banks with foreign participations, including 8 subsidiary banks, and 2 banks with 100 percent government participation. Along with this, 12 second-tier banks are part of banking groups.

15. The total assets of the banking sector amount to 44.6 trillion tenge or 43 percent of GDP, increasing by around 18 percent as compared to end of 2021. The largest share is represented by banks' loan portfolio—54.4 percent or 24.3 trillion tenge.

Sector	bln. tenge	%
Banks	44,6	79,2
Development Bank of Kazakhstan	3,9	7,0
Securities market firms	0,6	1,0
Insurance firms	2,1	3,7
Pawnshops	0,3	0,5
Credit partnerships	0,8	1,3
MFO	1,1	2,0
Mortgage lending non-banking organizations	1,5	2,6
Agribusiness lending	1,5	2,7
Total	56,3	100

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

A. Sound and Sustainable Macroeconomic Policies

16. Kazakhstan has been hit by multiple shocks in the last decade. The country was hit first by the oil price shock in the period 2014-2016, then by the COVID-19 pandemic in 2020, by social unrest in January 2022— triggered by an increase in liquefied gas prices following the lifting of a government-enforced price cap — and most recently by the fallout from the war in Ukraine. The latter exacerbated inflationary pressure, with the consumer price index reaching 20.3 percent y-o-y in 2022, almost twice as much as the previous year; and it also required the intervention of the authorities to manage the acquisition of three Russian-owned banks, of which one was systemically important.

17. The authorities have taken various measures to preserve stability and support the economy. The government introduced fiscal support measures estimated at 3 percent of GDP. NBK hiked its policy rate six times in 2022, from 9.75 to 16.75 percent, and intervened in the foreign exchange (FX) market to limit excessive exchange rate volatility. Near term recovery is contingent upon a more favorable external environment, long-term economic prospects depend on successful economic diversification, energy transition and climate resilience. The Kazakhstani financial sector has come through recent shocks relatively unscathed but financial stability risks warrant continuous vigilance.

B. Framework for Financial Stability Policy Formulation

18. After the spin-off of the ARDFM from NBK, the role of the Financial Stability Council (FSC) as a coordinating body on financial stability issues has been strengthened. The FSC is an advisory and consultative council, whose main objectives are to ensure financial system stability, identify systemic risks, and develop proposals for measures aimed at mitigating such risks. FSC is composed of: Governor of the NBK acting as the Chairman; First Deputy Head of the Presidential Administration; Chairman of ARDFM; Minister of Finance; and Minister of National Economy. The list of issues that are mandatory for preliminary consideration by FSC are: implementation of macroprudential policy, anti-crisis measures, resolution of insolvent banks, and financing banks' rehabilitation.

C. Public Infrastructure

19. The Insolvency Law has been strengthened, with the legal rights of secured creditors being reinforced. The secured creditor receives the right to accept the pledged property in physical form after getting the related proposal from the bankruptcy manager within five working days from his/her appointment. Provisions on rules on invalidation of fraudulent transactions were revised: the conditions to define a transaction as fraudulent were amended and a 10-day term was established to file an application for invalidating such transaction. A personal bankruptcy law was recently

approved. Recent reform announcements are an opportunity to accelerate the fight against corruption. In 2022, the President announced important steps toward political modernization, judicial reforms, and an increased role for civil society and the media (Article IV missions (Dec. 2022)).

D. Framework for Crisis Management, Recovery, and Resolution

20. The framework for crisis management, which was amended in 2019 with the introduction of specific instruments to resolve failing banks, has not been applied in practice.

Before this amendment, banking crises and resolutions were managed using old tools with frequent state intervention.

21. Notwithstanding this progress, the crisis management framework has substantial limitations. The MoU on Financial Stability Issues, signed in 2007, is outdated and NBK plans to develop a new triparty MoU that would involve NBK, the ARDFM, and the Government. Moreover, resolution responsibility is not separated from banking supervision: a resolution authority is currently not operative, and it is formally integrated into ARDFM Supervisory Department. There is no recovery and resolution planning framework: banks do not submit recovery plans and ARDFM Division 'Resolution of Problem Bank' does not prepare resolution plans for the systemic banks.

E. Public Safety Net

22. The Kazakhstan Deposit Insurance Fund (KDIF) was established in 1999; NBK is its founder and the sole shareholder. KDIF Board is chaired by the NBK Governor, while the remaining members are two representatives from the NBK and two independent members. As of December 31, 2021, 19 out of 21 banks operating in Kazakhstan were members of KDIF (two Islamic banks were the exceptions). The KDIF is responsible for conducting payouts; maintains a registry of member banks; participates in the transaction for simultaneous transfer of assets and liabilities of a bank to another (other) bank(s); invests in assets; forms a special reserve.

23. In 2021 the model to calculate the banks' contributions was modified and maximum insurance coverage amounts for savings deposits was increased. Premiums depend on each bank's financial condition and level of risk assumed: KDIF receives the SREP rating from ARDFM. The coverage for saving deposits in the national currency was increased to KZT 20 million, for depositors having other types of deposits in the national currency (beside the savings deposits) was set at KZT 10 million, while it is KZT 5 million on deposits in foreign currency.

24. The KDIF reserve in 2022 amounted to 5.7 percent of total insured deposits in member banks (a minimum of 5 percent is required by law). If the amount of obligations on insured deposits exceeds the amount of an insolvent bank's assets, KDIF is obliged to make up the difference at the expense of the special reserve. The legislative period for the start of payout is currently above the ones envisaged in the IADI principles.

25. The revised lender of last resort (LoLR) framework,⁵ which entered into force in 2019, provides liquidity support only to solvent banks that experience temporary liquidity problems. In 2020, following the spin-off of banking supervision, some amendments have been made to the LoLR framework. ARDFM is responsible for assessing the financial health of a borrower bank, while the NBK decides on the bank's application to join the agreement of the general terms of the LoLR.

26. Lack of an MoU between the ARDFM and the NBK undermines certainty in the operationalization of the LoLR framework. At present, collaborative efforts are underway between the Agency and the NBK to undertake a review of the regulations pertaining to the provision of LoLR, aligning with the annual Asset Quality Review conducted by the Agency.

F. Effective Market Discipline

27. The regulations on risk management and internal control for banks delineate the responsibilities of the banks' managerial and operational structure and reinforce key concepts of risk governance. To develop market discipline and enhance the transparency of the banks' activities, the authorities plan to introduce the third component of the Basel framework: the Disclosure Standard (Pillar 3).

MAIN FINDINGS

A. Responsibilities, Objectives, Powers, Independence (CP 1–2)

28. The high degree of variability of the framework for financial sector oversight prevents institutional continuity and capacity building. The recurrent reorganizations of the financial supervisory architecture entail risk in the transition from one entity to another (mandate, independence, budget, IT solutions, staff, etc.). From 2004 to 2011 regulatory and supervisory functions were performed by the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (FSA), an entity reporting directly to the President of Republic of Kazakhstan. Following the global financial crisis, the FSA was abolished (2011) and banking supervision integrated into the National Bank of Kazakhstan (NBK). More recently, with the Decree № 203 of the President of the Republic of Kazakhstan as of 11 November 2019 On further improvement of the public administration system of the Republic of Kazakhstan (Decree 203), the financial sector supervisory responsibilities of the NBK have been transferred to the newly established Agency of the Republic of Kazakhstan for the Regulation and Development of the Financial Market (ARDFM), which formally launched its operations in 2020. While there exists no "ideal" financial sector oversight model (financial supervision within or out of the central bank are both, in principle, valid solutions), its instability through time can per se reduce its effectiveness and efficiency.

⁵ Law on National Bank of the Republic of Kazakhstan March 1995 n. 2155, Art 51-3.

29. The safety and soundness of banks and banking system is not prioritized over other mandates in the law, particularly the development mandate. While this is not uncommon in emerging markets and developing economies (EMDEs), possible conflicts arise. For example, stimulating the flow of credit to the economy is one of the key performance indicators of ARDFM and this could come at the expense of the safety and soundness of banks and banking system. To manage the potential trade-off, the law should create a hierarchy among the objectives and the ARDFM embed such prioritization in public documents and strengthen its institutional arrangements (for example, management committees overseeing different functions, and escalation process enabling the consideration of the trade-offs in decision-making).

30. ARDFM independence is not enshrined in the legislation. Several provisions in the Law on State Regulation, Control, and Supervision of the Financial Market and Financial Organizations (Law N. 474-II 2003, amended as of 09/12/2022) undermine the ARDFM's independence which is "directly subordinated" to the President of the Republic of Kazakhstan and confer to him/her the power to approve its organizational structure and total staff. There is a lack of transparency in the process of removal of the governing body of the ARDFM, since the reasons for removal are not provided by the law. Moreover, there is no duty to publicly disclose the reason for removal. Also, one representative from the President of the Republic of Kazakhstan is a member of the ARDFM's Board. ARDFM is funded by the republican budget. While in theory this does not necessarily undermine its autonomy and operational independence, the assessors found actual constraints applied to ARDFM budget which impinge on its ability to carry out supervisory functions: hire external experts, carry out appropriate cross-border work on-site inspection, supervisory college), develop and maintain its proprietary IT system. Finally, ARDFM staff is not adequately protected from the cost of defending their actions and/or omissions made while discharging their duties in good faith.

B. Licensing, Changes in Control, and Acquisitions (CP 4–7)

31. As there have not been license applications since 2009, files were not reviewed during the assessment. Nonetheless, the ARDFM control mandate should be extended to assess the suitability of the Heads of control functions. In addition, ARDFM should periodically assess qualifying shareholders. The legal framework does not enable the ARDFM to assess the suitability of the heads of internal control functions (chief risk officer, chief compliance officer, and the internal audit), as they are not considered 'executive employees' (Banking Law n. 2444, Art. 20). Moreover, there are no grounds in the legislation which allow ARDFM to revoke a bank's license which was released based on false information. Also, ARDFM doesn't perform periodical reassessment of the shareholders with qualifying holdings to determine if they continue to meet the fit & proper requirements.

32. Laws and regulations related to licensing, changes in control, and acquisition define what constitutes significant control over an entity clearly, but the Banking Law lacks a definition of beneficial ownership and the "ultimate beneficial owner." A definition of beneficial owner does appear in relevant legislation pertaining to anti-money laundering and countering the financing of terrorism; in ARDFM staff's opinion, this definition may be applied in

matters concerning licensing and acquisitions. As these concepts are important to understanding control over an organization and are prominent throughout international standards such as the Core Principles, it would be useful either to explicitly reference the existing definition in the AML-related legislation or to provide the definition in the Banking Law directly.

C. Supervisory Cooperation, Consolidated and Cross Border Supervision (CP 3, 12, 13)

33. Laws and regulations provide for collaboration and cooperation between domestic authorities responsible for banking supervision, emphasizing the importance of confidentiality. Nonetheless, more must be done to align the ARDFM's approaches to its collaboration with foreign supervisors and to its supervision of banking groups.

34. The ARDFM should strengthen its home-host supervisory cooperation and the supervision of cross-border exposures and activities. While it has a number of memoranda of understanding with supervisors in the region and beyond, the ARDFM has not been sufficiently proactive in its approach to collaboration with those authorities. It has not revived or established any supervisory colleges for its internationally active banks. While only a few Kazakhstani banks maintain activities and offices abroad, at least one plays a significant role in the region, suggesting that more formal interactions with host supervisors could be beneficial to understanding its activities and risks. The ARDFM is lacking one MOU for the home country supervisor of a significant global bank that is active in Kazakhstan and should establish this relationship to make it easier to share information on the firm's activities with the home country supervisor.

35. The ARDFM should continue with its plans to align its key prudential standards with Basel and extend risk management expectations across a banking group and not solely at the level of the solo bank. Its present approach does not yet comply with international standards for consolidated supervision.

D. Supervisory Approach (CP 8–10)

36. ARDFM has recently transitioned to a risk-based approach (RBA) and the methodology for assessing nature, impact, and risk of banks feeds into SREP. The approach draws inspiration from the Eurozone Single Supervisory Mechanism (SSM) framework, which provides the main pillars for applying a forward-looking risk-based supervision. ARDFM's application of 'motivated judgement' (sometimes referred to as supervisory judgment or reasoned judgment) anchors the supervisory discretion to professional opinions and ensures the 'due process', by providing the addresses of a decision with the right to be heard and to disagree before the decision is adopted. However, this process can be extended beyond the five areas envisaged by the law (licensing, related party transactions, risk management and internal controls, provisioning, and major participants). In case an urgent action is needed to prevent significant damage to the financial system, the ARDFM should be able to adopt a 'provisional motivated judgment', giving to the persons concerned the opportunity to be heard as soon as possible after taking its decision. Although there is a framework in place for handling banks in times of stress, the ARDFM has not

carried out resolvability assessments. his process can be extended beyond the five areas envisaged by the law (licensing, related party transactions, risk management and internal controls, provisioning, and major participants). In case an urgent action is needed to prevent significant damage to the financial system, the ARDFM should be able to adopt a ‘provisional motivated judgment’, giving to the persons concerned the opportunity to be heard as soon as possible after taking its decision. Although there is a framework in place for handling banks in times of stress, the ARDFM has not carried out resolvability assessments.

37. ARDFM deploys several techniques and tools to implement its supervisory approach.

The representative of the ARDFM in a bank is the focal point for the supervisory processes and leverages his/her access to a wide range of information sources, formal and informal, to keep ARDFM abreast of the latest developments in the banks. The SREP is complemented by the ‘regular’ internal desk-based AQR, whose results are the starting point of the stress testing. However, ARDFM does not have a formal process to regularly assess the quality, effectiveness, and integration of its on-site and off-site functions. Making the AQR a regular (annual) exercise may have some advantages, but it also has some limitations. One advantage of an annual desk based AQR is that it can help the Agency focus, in its offsite and (even more) onsite activity, on the banks and portfolios that appear to be more exposed to risks, based on the internal desk-based AQR; however, it must be clear, from this perspective, that the internal desk-based AQR is instrumental to the other activities: i.e., a mean to an end, not an end in itself.⁶ The inspection function is robust, and findings are incisive, but they need to be prioritized, clarifying what needs to be corrected in the short-term (urgent) and what could be done in the medium-long term; interaction with independent board members should be strengthened; also, a more risk-focused approach is needed in certain areas (such as compliance with AML/CFT rules. Moreover, there seems to be scope for a greater use of horizontal thematic reviews (on corporate governance, cybersecurity, digital financial services, underwriting standards, related party transactions). The ARDFM should speed up the setting up of the Pillar 2 methodology.

38. The ARDFM has the power to access the information and reports from banks and groups collected by NBK. It should strengthen its guidance to banks on how they should validate and verify their estimates of the fair value of assets and describe the role of supervisors in evaluating the reliability and prudence of the fair market value estimates. In addition, the ARDFM should enhance regulatory reporting on IRRBB, by requiring banks to report the economic value of equity (EVE) and the net interest margin (NII) for each of the six scenarios prescribed by the Basel Committee for Banking Supervision.

39. ARDFM is dependent on the NBK IT systems for accessing data it may create some risks in case priorities of the two institutions diverge. It could be useful to take stock of all

⁶ Another advantage could be related to the assessment of granular portfolios, as the small amount of the single loans would require a disproportionately labor-intensive on-site inspection process, with the risk of limiting the credit file review to a negligible percentage of the lending portfolio. By contrast, the reliability of AQR as a remote off-site tool could be limited for assessing individually significant loans which require extensive review of documentation and discussion with banks. Hence, at least for the biggest corporate exposures, the desk-based AQR should be complemented by ad hoc on-site credit file reviews, if not recently captured by on-site inspections.

existing systems and data across both organizations and consider ways to strengthen, modernize, or build new platforms in the relevant organization to support a more effective and efficient supervision of the banking sector. This could form part of a new “SupTech” strategy for the two authorities’ aim to increase data quality, automate manual processes, enhance cooperation, satisfy relevant legal responsibilities and leverage relevant authority, and support the decision-making process with relevant data.

E. Corrective and Sanctioning Powers of Supervisors (CP 11)

40. The ARDFM has a range of supervisory response measures as well as sanctions at its disposal and makes use of them. The ARDFM exercised forbearance by loosening capital and liquidity requirements in response to the COVID-19 pandemic as well as the outbreak of war in Ukraine. Violations of the liquidity coverage ratio (LCR), net stable funding ratio (NSFR), other liquidity ratios due to outflow of deposits, and revaluation of assets and liabilities has been tolerated, subject to banks providing an action plan to address those violations within nine months. While these are meant to be temporary, the persistence of stressed conditions at global and regional level suggests that the requirements should be restored to their typical levels expediently to reduce the potential for risks to expand during this prolonged period of uncertainty.

F. Corporate Governance and Risk Management (CP 14, 15)

41. The regulatory framework for corporate governance and risk management has been strengthened by Resolution n. 188/2019 which addressed several findings of the 2014 BCP assessment; nevertheless, areas for improvement remain. There is no requirement for the board to introduce succession plans; the lack of a limit to multiple memberships could give rise to conflict of interests and in some cases impinge on the board of directors’ time commitment; ARDFM did not structurally assess bank compensation systems; banks are not required to prepare recovery plans. The supervisory assessment of corporate governance will benefit from carrying out targeted onsite inspections on corporate governance and conducting a thematic review to assess the state of implementation by the banking system of the Resolution n.188/2019. Finally, while the ARDFM can exert motivated judgment when assessing the risk management function, a key test will be implementing the challenging process of ICAAP and ILAAP in the context of the entire spectrum of Pillar 2 risk (for example, sovereign, interest rate, climate-related financial risks).

G. Capital (CP 16)

42. Kazakhstani banks transitioned to Basel II/III framework. Risk weighted assets for credit risk are in some case more conservative than those provided by the new standardized approach (for example, consumer lending, for which risk weights can reach as high as 350 percent—versus 75 percent in the Basel framework), but in other cases less conservative, namely for exposure to SME and syndicated loans. However, considering that consumer lending accounts for the largest share of total loans, at bank level the more conservative approach for consumer lending compensates for the less conservative risk weights envisaged for exposures towards SME. In any case, the preferential treatment for exposures towards SME and syndicated loans in tenge was scheduled to expire at end of December 2023 and the ARDFM did not prorogate it. The definition of capital is broadly

compliant with the applicable Basel standards, except for the revaluation reserves (which nevertheless represent, on average, only 0.6 percent of Total capital). The computability of *non-bailinable* subordinated debts into Tier 2 capital has been phased out between 2015 and 2020. The capital conservation buffer (CCB) for non-systematically important banks is set at 2 percent (instead of 2.5 percent); but the CCB for domestically significant important banks (D-SIBs)—the only internationally active banks in Kazakhstan—is set at 3 percent. No leverage ratio requirement is in place; the ARDFM is considering its introduction in 2024. Capital requirements do not fully reflect the banks' risk profile yet, but the roll-out of the draft methodology for Pillar 2 capital add-on is planned for 2024.

H. Credit Risk and Problems Assets, Provisions and Reserves (CP 17–18)

43. Despite the tightened capital requirements, the growth rate of consumer lending (about 40 percent in 2021 and 25 percent in 2022) remains a source of concern. Based on information received during the mission, it emerged that some banks are loosening their underwriting standards: for example, some banks are granting consumer loans that are used to make the minimum down payment on mortgage loans, or for repayment of overdue debt, including with other financial institutions, or by lending consumer loans to SME entrepreneurs. The Regulation does not cap the amount of a consumer loan in absolute terms, and this might open window of opportunities for unintended use on consumer loans. The ARDFM should require banks to strictly monitor the use of consumer loans and ensure that they are used for their intended objective. The ARDFM should also carry out a closer oversight of consumer loans and apply supervisory measures to those banks that do not strictly monitor the adequate use of those loans. Additionally, to the mentioned above risks related to consumer loans, the ARDFM should consider if this acceleration of the consumer lending is not driven by moral hazard generated by previous bail out of the debtors.

44. The prudential framework on problem assets and provisioning is not fully aligned with international standards. NPL recognition is limited to 90 days past due exposures (around 3 percent of banks' loans), but it does not include IFRS9 stage three loans (6.6 percent, as at end 2022), nor the "unlikely to pay" (UTP) exposures (namely, foreclosed assets). The official definition of NPL should be aligned to the international standards, including for reporting of Financial Soundness Indicators to the IMF. Resolution n. 269 does not set timely write-off requirements on uncollectable loans.

I. Risks (CP 19–25)

45. The law provides a broad definition of related party, and the supervisor can exert motivated judgment when recognizing a person as a bank's related party or a transaction as made on a preferential term. However, the risk inherent to related party exposures by banks that defaulted between 2020 and 2021 was higher than officially reported, as verified by the assessors on evidence shared by ARDFM. Moreover, the possibility to transfer distressed assets at non-market terms to subsidiaries acquiring dubious and hopeless assets of the parent bank distorts the correct reflection of credit risk, inflates banks' profits, and delays the creation of the distressed asset market. Supervision of liquidity risk should be strengthened. The Agency should exit liquidity forbearance measures and set up LCR and NSFR at 100 percent; structurally assess banks liquidity contingency

funding plans: and perform a more thorough monitoring of liquidity in foreign currency, including liquidity stress test in foreign currency.

46. Supervision of interest rate risk in the banking book (IRRBB) is at an infancy stage. The ARDFM is raising awareness in the banks, and recently requested to quantify exposure to IRRBB through the supervisory indicators of economic value of equity (EVE) and net interest income (NII); nevertheless, the impact of IRRBB on the EVE is quantified only in relation to two out of the six scenarios prescribed by the Basel Committee for Banking Supervision. Moreover, ARDFM does not verify the information provided by banks, due to the lack of a challenger model, and it has not identified outliers. After the mission, the Agency presented some on-going work aimed at improving the supervision of IRRBB. This would take place through the expansion of the scenarios for EVE and the development of a challenger model. However, the concrete implementation remains to be seen.

47. While the ARDFM has incorporated supervision of other specific risks such as market and operational risk into its SREP,⁷ the ARDFM's approaches to these specific risks require further development. Market risk is incorporated into stress testing, for example, but currently stress testing results do not contribute to the calibration of additional capital requirements. The ARDFM seeks to enhance its supervision of operational risk and has decided to adopt the basic indicator approach from the Basel Committee's framework,⁸ which require supervisor validation/review of bank's historical internal loss data; however, the gathering of loss data that exceed 500 thousand tenge is being implemented only this year. In addition, for outsourced functions, the ARDFM is encouraged to clarify in its guidance that internal audit must have the authority and resources necessary to evaluate risks associated with tasks undertaken on behalf of the bank by third parties.

48. Finally, at the time of the onsite visit, the ARDFM needed to strengthen cybersecurity capacity, which raises concerns given how prominent IT and cybersecurity risks are globally and rapid digitalization of the financial sector. The ARDFM should invest in the training of existing staff and the recruitment of professionals with appropriate skills and expertise to enhance its capacity in this important area of operational risk, including encouraging its staff to attain internationally recognized professional certification in this important area of operational and cyber risks.

J. Disclosures and Transparency (CP 27–28)

49. Some disclosure requirements should be strengthened, and the ARDFM should have more authority over the supervision of external auditors. Supervisory authorities have adopted rules and regulations that are broadly aligned with international standards regarding financial reporting and external audit, including correcting some deficiencies noted at the prior assessment

⁷ Supervisory Review and Evaluation Process, a supervisory practice used across the European Union.

⁸ The ARDFM's adoption of the basic indicator approach for operational risk became effective on January 1, 2023 and was not observable as implemented at the time of the onsite mission for the FSAP.

related to the rotation of external auditors. Supervisors should also have the power to limit conflicts of interest that may arise when an auditor provides consulting services to the same client.

50. The ARDFM should be empowered to reject or rescind the selection of an external auditor that it considers to be inadequate, insufficiently independent, or not aligned with established professional standards. Currently ARDFM doesn't have the power to reject or rescind the selection of an external auditor even if it has significant concerns related to qualification, independence or other factors that may significantly impact the quality of audit.

51. One important exception to international standards is that laws and regulations do not require the disclosure of all material entities within a corporate group structure. This may undermine the presentation of the situation of a truly consolidated banking group and reduce the market's insight into its condition. Supervisors should amend the relevant regulations or rules to require the disclosure of all material entities that exist within a group, as well as reporting of information related to risk management strategy, governance, and remuneration.

K. Abuse of Financial Services (CP 29)

52. While the ARDFM has adopted an ambitious approach to implement and enforce the existing legislation and regulations, its approach to onsite inspections appears to lack a risk-focused perspective. Laws and regulations have been amended significantly to address many of the deficiencies identified by the prior BCP assessment. Nonetheless, its extensive efforts to review all customer documentation and to evaluate every transaction a supervised institution has undertaken introduces the risk that responsibility for identifying risks associated with money laundering and terrorist financing may be perceived as shifting from the firms to the ARDFM. The approach sets a high cost in terms of time and resources for the ARDFM and potentially diminishes its ability to spot problems.

53. The ARDFM should continue to invest in its staffing and technology for AML/CFT, including potentially procuring appropriate IT tools for conducting evaluations of customers and transactions when necessary. After the mission, the assessors were informed that the ARDFM is building some new tools for AML/CFT supervision, which remain under development. The ARDFM should additionally consider encouraging key managers and staff to seek internationally recognized professional certificates in AML/CFT as a means of ensuring that its staff is well prepared to evaluate banks' practices and staff in the field. Finally, given the wide range of responsibilities assigned to the team covering AML/CFT, it may be useful to establish specialized teams for the most significant topics beyond AML/CFT, such as fraud, crypto-related activities, and so on.

DETAILED ASSESSMENT

A. Supervisory Powers, Responsibilities and Functions

Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ⁹ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ¹⁰
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ¹¹ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>The banking supervision architecture in Kazakhstan has historically shown a high degree of variability, particularly in the wake of episodes of financial instability. From 2004 to 2011 the regulatory and supervisory functions were performed by the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (FSA), an entity reporting directly to the President. Following the Global Financial Crisis, the FSA was abolished (2011) and banking supervision integrated into the NBK. Most recently, with the Decree № 203 of the President of the Republic of Kazakhstan as of 11 November 2019 On further improvement of the public administration system of the Republic of Kazakhstan (Decree 203), the financial sector supervisory responsibilities of the NBK have been transferred to the newly established authorized body Agency of the Republic of Kazakhstan for the Regulation and Development of the Financial Market (ARDFM), which formally launched its operations in 2020.</p> <p>According to the Authorities, the spin off was motivated by the need to avoid conflict of interest between monetary policy and banking supervision.</p> <p>The responsibilities and objectives of ARDFM are defined by both (i) the Law of the Republic of Kazakhstan "On State Regulation, Control and Supervision of Financial Market and Financial Organizations" dated 04.07.2003 № 474 (L. 474-II) and (ii) the</p>

⁹ In this document, "banking group" includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

¹⁰ The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

¹¹ Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

	<p>Decree n. 203, which spells out mission, main tasks, functions, right and obligations of the Authority (Chapter 2).</p> <p>Law 474-II art. 3 identifies:</p> <ul style="list-style-type: none"> • <u>two goals</u> (a) assistance in ensuring financial stability and maintain confidence in the financial system and (b) creation of equal conditions for the activities of financial organizations. • <u>four tasks</u> (a) establish the standards for the activities of financial organizations; (b) monitoring of financial market and financial organizations; (c) concentrate supervisory resources in the areas most exposed to risk to ensure financial stability; (d) ensuring appropriate level of protection of the interest of consumers of financial services. <p>Decree n. 203:</p> <ul style="list-style-type: none"> • <u>defines ARDFM mandate</u> which consists of '<i>ensuring an appropriate level of protection of the rights and legitimate interests of consumers of financial services, contributing to the stability of the financial system and the development of the financial market, exercising state regulation, control over and supervision of the financial market and financial institutions, as well as other persons, within its competence</i>' (art. 1). • establishes the <u>mission of the ARDFM</u>: (a) regulation and <u>development</u> of the financial market (b) promotion of financial stability of the financial market and financial organizations, (c) maintaining confidence in the financial system as a whole (d) creating equal conditions for the activities of financial organizations. • enucleate <u>the same four tasks</u>, identified by Law 474-II. <p>Moreover, according to Central Banking Law, NBK still '<i>contributes to ensuring the stability of the financial system</i>' (Law n. 2155 '<i>On the National bank of the Republic of Kazakhstan - NBK Law, Chapter 2</i>) and ARDFM should interact with NBK to pursue this objective (Decree n. 203, Chapter 2, par. 15, point 22). Nevertheless, ARDFM has not stipulated a Memorandum of understanding (MOU) with NBK yet, but only an information sharing agreement. The agreement excludes exchanges of information related to documents classified as "<i>For Official Use</i>" and for those covered by state secrets. The sharing of information can occur also through reciprocal access to the IT system to a list of employees.</p> <p>An old MOU was at that time (2007) stipulated by the previous Agency for Supervision, the Government, Ministry of Economy and Budget Planning, and Ministry of Finance. To strengthen inter-agency cooperation, NBK is drafting the new MOU for further discussion with the ARDFM and other relevant authorities.</p>
EC 2	<p>The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinated to the primary objective and do not conflict with it.</p>

Description and findings re EC2	<p>ARDFM is assigned with broader responsibilities which are not explicitly subordinated to the safety and soundness of banks and the banking system.</p> <p>Considering the combined provision of Law 474-II and Decree n. 203, financial stability goals coexist with (i) consumer protection, (ii) competition (<i>'creation of equal conditions . . .</i>) and (iii) development of financial markets.</p> <p>While the consumer protection mandate can even complement the banks' safety and soundness' goal, for example, by mitigating legal and reputational risks stemming from relationships with retail customer, the development mandate can instead conflict with the financial stability objective, and it is not subordinate to it. In the questionnaire accompanying the self-assessment, the ARDFM admitted that the Law does not provide for the priority of these goals.</p> <p>An example of conflict is provided by the ARDFM KPIs, which set target for increase in total banking loan portfolio "from 2019" (20–28 percent in 2022) and "from 2021" (38 percent in 2023), as well as in banking loans to legal entities "from 2021" (17 percent in 2023 and 28 percent in 2024). Such an improper function of stimulating banks' lending might be pursued by relaxing capital requirement and/or not implementing minimum prudential standards. For example, to stimulate lending to SME, ARDFM reduced risk weighed assets from 75 percent to 50 percent; to support project financing exposures to legal entities in domestic currency with the form of syndicated loans are risk weighted at 50 percent, regardless of the entities' external rating (see CP16). Moreover, a capital conservation buffer for banks other than Domestically Significantly important (D-SIB) has been set at 2 percent instead of 2.5 percent; while a leverage ratio requirement is not in place at all. In addition, to develop alternative forms of business financing and lending, the Agency proposed tax incentives for syndicated loans, leasing and factoring (ARDFM Annual Report 2021).</p> <p>Risk of conflict might also arise in relation to the ARDFM's role in the development of innovations, financial technologies, new business models and competencies in the financial market. Based on the <i>Concept of Development of the Financial Sector of the Republic of Kazakhstan until 2030</i>, approved with Decree President of the Republic of Kazakhstan in 2022, the ARDFM, to stimulate technological development, will have to:</p> <ul style="list-style-type: none"> • bring regulation in line with the needs of the development of digital technologies. • introduce regulatory sandboxes. • develop standards for open banking technologies. • consider the possibility to authorize banks to form and have equity interest in the capital of Fintech (for example, companies involved in online trading and provision of services), with a limit of 15 percent of equity for all investments in non-financial assets. <p>The broader goals are to promote the digitalization and the creation of favorable legal condition and environment for the introduction of new technologies, support innovation in the financial market, development of a digital financial infrastructure, and the use of <i>block-chain technology</i>. There is a crypto pilot project in the Astana International Financial Centre (AIFC), which is jurisdictionally separated from the</p>
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	<p>domestic financial system (separate non-crime legislation, based on common law, and separate judicial). The aim of the AIFC is to attract capital, carry out activities that serve largely international clients, and help develop domestic financial markets. Commercial banks are not able to have direct or indirect exposures to crypto assets, although authorities admit monitoring indirect exposures can be difficult. As part of the AIFC pilot, under the supervision of ARDFM and NBK, commercial banks provide fiat settlement rails for Astana Financial Service Authority (AFSA) registered exchanges.</p> <p>While technological financial innovation in the financial services can increase efficiency, reduce costs, and improve competition, this might also come with risks. . For example, episodes of market stress in the crypto currency trading platforms showed multiple vulnerabilities (flaw in the governance, inappropriate business model, operational fragilities, liquidity and maturity mismatches, leverage, interconnectedness). The Authority has not strategized the implementation of FSB recommendations for Regulation, Supervision and Oversight of crypto-asset activities and markets (October 2022). ARDFM should also remain vigilant on banks' indirect exposures towards unbacked crypto assets or global stable coins without an effective stabilization mechanism (BCBS, <i>Prudential treatment of crypto assets exposures</i>, 2022), as well as towards mining activities.</p> <p>On the positive side, the ARDFM organigram envisages different reporting lines between consumer protection, financial literacy, on the one hand, and banking regulation and supervision. on the other hand. Nevertheless, ARDFM does not have an internal policy on how avoid that the development objectives are reached at the expense of the safety and soundness of banks and banking system.</p>
EC3	<p>Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile¹² and systemic importance.¹³</p>
Description and findings re C3	<p>ARDFM can set '<i>prudential standards and other mandatory standards and limits</i>' for banks and banking groups (art. 41 Law on Banks and Banking Activity in the Republic of Kazakhstan – Banking Law or BL 2444).</p> <p>Prudential standards might cover not only the areas explicitly spelled out by BL 2444 for banks (capital, concentration, liquidity, and currency risk) and banking groups (capital, and concentration), but also additional standards and limits '<i>used in the international practices</i>' (art. 42, par. 1, BL 2444).</p> <p>ARDFM power to set standards is also enshrined in Decree 203 (art. 14).</p> <p>ARDFM can enforce capital prudential standards to address lack of compliance with the established requirements (art 42 par. 2 BL 2444) requesting banks and banking</p>

¹² In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

¹³ In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>groups breaching capital adequacy ratios to submit a recapitalization plan (art 42 par. 4 BL 2444).</p> <p>ARDFM can also set and enforce prudential standards and other mandatory norms and limits for branches of non-resident banks (art. 42, para. 6, BL 2444).</p> <p>ARDFM can <u>increase</u> the prudential requirements for individual banks and banking groups. BL 2444 art. 46 empowers the ARDFM, in order to eliminate deficiencies, risks or violations, including those identified through motivated judgment, to apply measures to improve the financial condition and (or) minimize the risks of the bank, an organization carrying out certain types of banking operations, a banking holding, a banking group and (or) organizations within the composition of a banking group, a major participant in the bank. Among these measures, the banking law envisions, for example, maintenance of capital adequacy ratios and (or) liquidity ratios above minimum values established by the ARDFM.</p> <p>ARDFM is currently working on methodology for determining the Pillar 2 ("<i>supervisory allowance</i>") which will consist of three components: (i) a risk premium, based on quantitative parameters); (ii) and allowance for deficiencies in risk management systems, business model and corporate governance, based on qualitative parameters; (iii) surcharge for stress test (see CP16, EC4)</p>
EC4	<p>Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.</p>
Description and findings re EC4	<p>NBK Board Resolution dated November 12, 2019, No. 188, '<i>Rules for formation of risk management and internal control system for second-tier banks</i>' (Resolution 188) is one of the major updates of the regulatory framework in the last years. It has a cross cutting nature and contributed to strengthening corporate governance, risk management, internal controls, ICAAP, ILAAP, credit, market, and operational risks supervisory standards (see concerned CPs).</p> <p>ARDFM should continue to upgrade regulation in collaboration with NBK (for example to avoid secondary sanctions, improve banks' resolution framework, tightening related party lending).</p> <p>Amendments to regulations and legal acts are subject to consultation. They are published on the ARDFM website for public discussion by users. At the same time, the ARDFM sends letters with a link to the draft regulation and legal act to the Association of Financiers of Kazakhstan and the National Chamber of Entrepreneurs to receive expert comments. Public discussion is carried out on the portal within 10 working days. If there are comments, the ARDFM provides a response within one day of the moment of receiving the comment. After the end of the public discussion period, the ARDFM uploads the received comments. According to the ARDFM, market participants disclosed their satisfaction with the interaction with the ARDFM during the regulation's development process.</p>

EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	<p>L. 474-II entitles ARDFM to receive full access to the necessary information, including those constituting service, commercial, banking, and other secrets protected by law (art. 14). It also enables the ARDFM to conduct inspections based on risk assessment, unscheduled inspections, and documentary checks (art. 15-2 and 15-4).</p> <p>The Banking Law:</p> <ul style="list-style-type: none"> • enables the ARDFM to verify the activities of banks, major participants of banks, bank holding companies and participants of bank groups either independently or with the involvement of other state bodies/organizations (art. 44). • obliges major participants of banks, bank holding companies, participants of bank groups, and their affiliated persons to assist ARDFM on the issues specified in the inspection mandate, and to provide opportunity to interview any officials and employees and access to any sources of information necessary to perform verification (Art. 42 par 2). • envisages ARDFM right, when conducting an audit of the activities of a branch of a non-resident bank of the Republic of Kazakhstan, to receive information from the home Supervisor within which an MOU has been stipulated for the exchange of confidential information (Art. 13-1 Art. 13-1, par. 1, subparagraph 3). <p>Decree n. 203 empowers ARDFM to <i>'request and receive free of charge from any individuals and legal entities, their associations (unions), branches of non-resident banks . . . as well as state bodies necessary information, including information constituting official, commercial, banking and other secret protected by Law'</i> (art. 16, point 2), and to carry out inspections and other forms of control and supervision, also with the involvement of NBK, audit and other organizations (art. 16, point 3).</p> <p>The ARDFM can also access information by appointing a representative in the banks (CP8).</p>
EC6	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.

Description and findings re EC6	<p>BL 2444 has been amended to strengthen the supervisory power to take action against a problem bank while formally complying with prudential requirements.</p> <p>Early Response Measures</p> <p>If ARDFM identifies factors affecting the deterioration of the financial conditions of a bank or banking group, or after the results of an inspection, it could adopt “<i>early response measures</i>,” namely request an action plan to improve the financial stability of the bank/banking group, preventing worsening of its financial condition and growth of risks. (art. 45). The factors considered by ARDFM are specified by NBK Regulation n. 317/2018 and comprise: (i) for banks, reduction of liquidity ratios, deterioration in asset quality, weakened profitability, and FX exposure; (ii) for banking group, capital adequacy, concentration risk and intra-group transactions (see CP 11). However, art. 45 par. 7 exempts non-resident bank holding company rated no lower than “A” from early intervention measures if an agreement for information exchange is in place between ARDFM and the home supervisor. This restrains the supervisor from initiating early response measures.</p> <p>Supervisory response measures</p> <p>When a bank/banking group is not complying with law or regulation, ARDFM can apply:</p> <ul style="list-style-type: none"> a) “<i>Recommendatory measures</i>” against banks (including non-resident branch) and bank holding company (Art. 45-2), or b) “<i>Measure to improve financial stability or minimize risk</i>” against banks (including non-resident branch) and bank holding company (Art. 46). c) “<i>Compulsory supervisory response measures</i>” against <u>major participants</u> (an individual or legal entity own directly or indirectly ten or more percent of the bank’s shares—see EC6) of banks, bank holding company, organization of a banking group (47-1). <p>The grounds for measure under let a) and b) are identified by Art. 45-1 and the choice of the appropriateness of the measures depend on the impact of the violation, deficiencies, or risk on the financial stability of the bank/banking group, being the measure progressively intrusive.</p> <p>Compulsory measures under let c) are adopted when supervisory response measures cannot ensure the protection of depositors and creditor, the financial stability of the banks/banking group or the minimization of risk; or when the actions (inaction) of a bank holding company and (or) a major participant of the bank may lead to further deterioration of the financial situation of the bank, a bank holding company; as well as in other specific cases provided by the Banking Law.</p> <p>ARDFM can also apply sanction (Art. 47-2) and suspend or revoke a banking license (Art. 48). The ARDFM is the resolution authority.</p> <p>More details on these supervisory powers are provided under CP 11.</p>
EC7	<p>The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.</p>

Description and findings re EC7	<p>The Banking Law defines a <u>banking conglomerate</u> ("banking group," in the following) as group of legal entities consisting of a banking holding company and a bank, as well as subsidiary organizations of the banking holding company and/or the bank, and/or organizations in which the banking holding company and/or its subsidiary organizations and/or the bank have significant ownership in the capital (art. 2 n. 3).</p> <p>Verification of activities of banks, major participants of banks, bank holding companies and participants of bank groups are conducted by the authorized body independently or with involvement of other state bodies and (or) the organizations (BL 2444 art. 44). When conducting verification of activities of banks and (or) participants of banking groups ARDFM has the right to inspect the activities of the affiliated persons of banks "<i>solely for the purpose of determining the extent and nature of their influence on the activities of banks.</i>" Nevertheless art. 44 par. 2 does not enable ARDFM to inspect the affiliated of bank holding companies.</p> <p>Moreover, banks, major participants of the banks, bank holding companies, participants of bank groups, and their affiliated persons are obliged to assist ARDFM on the issues specified in the inspection mandate, and to provide opportunity to interview any officials and employees and access to any sources of information necessary to perform verification (BL 2444, Art. 44 par 2).</p> <p>In practice, the supervision of holding and parent companies is not carried out. However, the ARDFM argued that in most banks, parent and holding companies are represented as nominal companies that do not carry out active operations.</p>
Assessment of Principle 1	Largely Compliant
Comments	<p>The safety and soundness of banks and banking system is not prioritized over other mandates in the law. While a promotional mandate is not uncommon to emerging markets and developing economies (EMDEs) supervisors, conflicts might arise with the financial stability goal, since the law does not prioritize the ARDFM's objectives. For example, stimulating the flow of credit to the economy is a KPI of the ARDFM and this could come at the expense of the safety and soundness of banks and banking system. Similarly, ARDFM (and NBK) have been tasked with the goal to create an environment for the introduction of innovations, the development of a digital financial infrastructure, and the use of block-chain technology (Concept for market development of the financial sector until 2030). While financial innovation can enhance the resilience of the banking system (for example, through more efficient and effective internal control systems) it might also create new risks for banks (cyber, crypto-assets, AML/CFT, data privacy, consumer protection, etc.) putting pressure on ARDFM at the expense of financial stability, regardless of their potential merits in advancing the public interest.</p> <p>However, the assessors acknowledge that ARDFM has adopted some institutional arrangements to manage this trade-off: financial inclusion and consumers protection divisions report to the First Deputy Chairman, while banking regulation department report to another Deputy Chairman. Both Deputy Chairmen participate in the Supervisory Committee.</p>

	<p>The lack of a MOU between NBK and ARDFM has been weighed under CP3, while the limited power to review the activities of the parent companies (inability to carry out on-site inspections), has been weighed under CP12.</p> <p>Recommendations</p> <ul style="list-style-type: none"> Given the broader responsibilities assigned to the ARDFM, the law should clearly state that the primary objective of the Supervisor is to promote the safety and soundness of banks and the banking system. Once a hierarchy of objective is provided by the law, ARDFM should embed the priority of safety and soundness of banks over other mandates in a public document, to make it clear that its decisions will appropriately balance potentially competing objectives and reinforce the motivation for the adoption of consequent institutional arrangements. ARDFM should eliminate lending growth rates from its KPIs.
Principle 2	<p>Independence, accountability, resourcing and legal protection for supervisors.</p> <p>The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.</p>
Essential criteria	
EC1	<p>The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.</p>
Description and findings re EC1	<p>The ARDFM argues that, according to the Law 474-II art. 15, <i>“State bodies are not entitled to interfere in the activities of the authorized body for the implementation of its legally enshrined powers;”</i> however, the same article goes on: <i>“with the exception of cases provided for by the legislative acts of the Republic of Kazakhstan.”</i></p> <p>In effect, Law 474-II contains several provisions that may compromise ARDFM independence. The ARDFM:</p> <ul style="list-style-type: none"> is “directly subordinated (and accountable) to the President of the Republic of Kazakhstan” and should act in the basis of the <u>Regulation approved by him</u> (art 6-1) “carries out its activities in accordance with the Constitution and laws of the Republic of Kazakhstan, acts of the President and the Government of the Republic of Kazakhstan, other regulatory legal acts of the Republic of Kazakhstan, as well as this Regulation.” <p>The organizational structure and the total staff of the ARDFM is approved by the President of the Republic of Kazakhstan (art. 6-2) which directly jeopardizes the operational independence.</p>

	<p>Other provisions which undermine the supervisor's independence pertain to the process for removal of the Chairperson (EC2); its internal governance (EC5); financial independence (EC6); and the legal system of protection (EC 9).</p> <p>The Decree n. 203/2019 with whom the President of the Republic of Kazakhstan approved the Regulation of the ARDFM does not prescribe ARDFM independence.</p> <p>There is no direct rule on the independence of the ARDFM in the legislation.</p> <p><u>NBK Independence</u></p> <p>In a similar vein, the independence of NBK, which is tasked with the goal to contribute to the stability of the financial system, is still threatened by the same deficiencies highlighted by the 2014 BCP.</p>
EC2	<p>The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.</p>
Description and findings re EC2	<p>The Chair of the ARDFM is appointed by the President of the Republic of Kazakhstan for a period of 6 years and dismissed by the President (Decree 203, Chapter 3, art. 13; similarly, L. n. 474-II art. 6-3). Neither the law nor the decree specifies the reasons for removal. ARFRDM argued that:</p> <ul style="list-style-type: none"> • Law of the Republic of Kazakhstan "On State Service" provides for the cases in which the powers of political state officials are terminated (art. 59) • Political civil servants shall submit and resign on the grounds and in accordance with the procedure established by the Constitution, this Law and other legislation of the Republic of Kazakhstan (art. 60). • If the grounds for resignation are not provided for by the legislation of the Republic of Kazakhstan, political civil servants shall be dismissed on the general grounds provided for by this Law or by the labor legislation of the Republic of Kazakhstan. • The grounds and procedure for dismissing political state officials are determined by the President of the Republic of Kazakhstan. <p>At the same time, the Constitutional Law of the Republic of Kazakhstan "On the President of the Republic of Kazakhstan" does not contain specific grounds for the termination of the Civil Service ARDFM by the Chairman, enabling a removal including for reasons beyond those provided by EC 2. Moreover, there is no duty to publicly disclose the reason(s) for removal.</p> <p>The three Deputy Chairs are also appointed for six years and dismissed by the President of the Republic of Kazakhstan, on the proposal of the Chair (Law 474-II art. 6-4).</p> <p>The main decision body of the ARDFM is the Board, which include the Chair, the three Deputy, one representative from the President of the Republic of Kazakhstan and one representative from NBK (art. 6-6). EC6 elaborates on the governance structure.</p>

EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ¹⁴
Description and findings re EC3	<p>Pursuant to L. n. 474-II art. 6-1, the ARDFM is accountable to the President of the Republic of Kazakhstan and acts based on the Regulation approved by him. ARDFM is guided by the Constitution of the Republic of Kazakhstan, the Law n. 474, other laws of the Republic of Kazakhstan, acts of the President of the Republic of Kazakhstan and international treaties of the Republic of Kazakhstan.</p> <p>The ARDFM is cognizant that an important factor in the sustainable and progressive development of the financial sector is the consistency, predictability, and transparency of the supervisory policy. In this regard, as well as to ensure active communication of the supervisory measures taken and to clarify the principles, mechanisms, and expectations of the new model of risk-based supervision, the ARDFM developed and published the Key Supervisory Policy Priorities for 2022.</p> <p>They include the expansion of the internal desk-based asset quality review (AQR) and stress testing to complement the SREP, the development of consolidated supervision, increasing the areas for the application of a motivated supervisory judgement, improving the Pillar 2 methodology and strengthening ICAAP and ILAAP supervisory assessment, developing and implementing IRRBB methodology, developing a market for stressful assets including through a trading platform, and enhancing collateral assessment.</p>
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	<p>The internal governance structure of the ARDFM (Decree n. 203/2019) reserves for the Board the most important supervisory decisions. The law enables the Chairman to object to Board's decisions within a week and return them for re-discussion and voting. If the Board confirms the decision taken earlier by two-thirds of their total number of votes, the Chair must sign it (Law n. 474-II art. 6-7).</p> <p>The Chair</p> <p>Pursuant to Law 474-II The Chair acts on behalf of the ARDFM and is empowered to make operational and executive-administrative decisions, with the exception of the powers reserved to the Board. The chairman is responsible for the activities of the ARDFM (art. 6-3). The Regulation of the ARDFM confers to the Chair various powers: among them, he/she can recommend a candidate for the position of Deputy Chair; appoint and dismiss officials reward outstanding employees; impose disciplinary sanctions; appoint and dismiss ARDFM member of the NBK Board; represent the ARDFM; distribute duties and determine powers among the Deputy Chairs. (Decree n. 203/2019, Chapter 3, par. 20)</p> <p>The Board</p> <p>The Board meets as necessary, in accordance with the work plan approved by the Chair. As regards decisions in case of emergency, unscheduled meetings are held</p>

¹⁴ Please refer to Principle 1, Essential Criterion 1.

at the request of the Chair or two members. The members of the Board are timely notified of the meetings.

The meetings are chaired by the Chair or, and in case of absence by the person replacing him/her. The Board make decisions with the participation of at least two thirds of the members, including the Chairman or a person replacing him. The decisions are taken by a simple majority of votes. In case of equality of votes, the vote of the Chairman is decisive.

The Board determines the priorities in the field of formation and development of the financial market; adopts legal acts regulating the activities of the financial market and financial organizations; determines the procedure for applying supervisory response measures; decides on the participation of the ARDFM in international organizations; submits for approval to the President of the Republic of Kazakhstan the structure and the total staffing of ARDFM, as well as the Annual Report; approves the terms of remuneration and social security of employees (Law. 474-II Art. 6-5)

According to the ARDFM's regulation, the Board decides on:

- limits to the ownership in the capital of bank and bank holding company.
- licensing banks and branches of non-resident banks, as well as establishment and acquisition of subsidiaries, including those specialized in NPL acquisition.
- significant and major participations of banks and banks holding companies.
- voluntary reorganization (merge, accession, division, allocation, transformation, converting) of banks/bank holdings companies, voluntary liquidation of banks, and voluntary termination of activity of branches of non-resident banks.
- classification of bank and branch of non-resident bank as insolvent and exclusion from this category.
- suspension, renewal, or revocation of banking license.
- introduction of the bank's conservation regime, moratorium, and application of measures for the settlement of an insolvent bank/branch of a non-resident bank.
- trust management of the shares owned by a major participant, or a person with the signs of a major participant in a bank, a bank holding company.
- set up and finance the stabilization bank.
- invite the Government to consider the possibility of acquisition (or the national managing holding) of the shares of a bank, when the actions taken to improve its financial conditions failed.
- compulsorily redemption of the bank's shares, if a bank has a negative capital, and the subsequent (mandatory and immediate) sale to a new investor guaranteeing the necessary improvement in the bank's financial position.

The Supervisory Committee

Additionally, to make operational decisions regarding supervision issues, the ARDFM set up a Supervision Committee. The Committee on the Policy of Prudential Regulation and Development of the Financial market of the ARDFM was established in 2020, to consider issues related to assessing and monitoring the risks of the financial system of the Republic of Kazakhstan and systemically important financial institutions, determining the policy for the development of the financial sector,

	<p>including those involving changes in prudential regulation to ensure financial stability. Members of the Committee are the Chairperson of the ARDFM, the First Deputy Chairman, directors of the Departments (Methodology and Prudential Regulation, Bank Regulation, Banking Analytic and Stress Testing, Insurance market and actuarial calculations, Securities Market, Strategy and Analysis, Supervision of Non-Banking Organizations). It also includes the Deputy Governor of NBK and directors of departments (Financial stability and Research, Financial Organizations Development).</p> <p>The Committee considers the following issues:</p> <ul style="list-style-type: none"> • the results of the analysis and assessment of the risks of the financial system and individual financial institutions. • proposals to reduce the risks of the financial system and (or) individual financial organizations to ensure the stability of the financial market. • issues of regulation of the financial market and (or) financial organizations, including within the framework of macro-prudential policy, taking into account international standards. • issues on changing approaches to the policy of supervision of financial institutions. • other issues to ensure stability and development of the financial system. <p>The Committee makes decisions on the issues submitted to the meeting; develops recommendations and (or) proposals; performs other functions within the framework of its powers.</p> <p>As regard conflict of interest, the Chairman and the Deputies are prohibited from purchasing share of investment funds, bonds, and share of commercial organization (Law of Republic of Kazakhstan 'on Combating Corruption' art. 13, par. 4 and Law of the Republic of Kazakhstan 'on Public Service' art. 3, par. sub. 3).</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings re EC5	<p>Considering that ARDFM is a nascent Authority, it is premature to judge on its overall credibility, which will have to be proved in the years ahead, particularly when dealing with the compounding crisis (pandemic, geopolitical tension, impact of inflation on banks' balance sheet, climate related financial risks) and its effect on the safety and soundness of the banking system.</p> <p>The professionalism of the staff benefits from NBK experience; recruitment procedures give priority to candidates with international certificates. One area which the ARDFM wishes to strengthen is related to IT skills.</p> <p>As regards staff integrity, employees of the ARDFM are not entitled to purchase units of investment funds, bonds, and shares of commercial organizations. Employees of the ARDFM are obliged to transfer to trust management units of investment funds, bonds, and shares of commercial organizations within one month from the date of taking up the position of an employee of the ARDFM. (Law n. 474-II, Art 15-13, subpar 11, par 2 and 3). The same rule applies also to NBK staff (Law 2155/2013, Art. 20-4). In addition, The ARDFM's policy on prevention and settlement of conflicts of interest n. 235/2022 imposed to employees, among others, the duty to</p>

	<p>notify conflicts, and to perform duties in the interests of the ARDFM. It also envisages a whistleblower mechanism that should process all communications, except those anonymous. Moreover, the Chair of the ARDFM is obliged to take measures to combat corruption (Decree n. 203/2019 Chapter 3). There is also a Code of Corporate Culture (Order № 107 of 10.02.2020) which identifies the main corporate values, which include competence and professionalism, responsibility, and conscientious attitude towards fulfilling their responsibilities.</p> <p>There are rules to ensure the appropriate use of information obtained through work with sanctions in place if these are not followed. Pursuant to Art. 44, par 3, BL 2444, the ARDFM's employees are prohibited from disclosing or transferring information to third parties, obtained during the verification of activities of the banks, major participants of banks, bank holding companies and members of banking groups. Moreover, ARDFM employee are bound to not disclose to third parties official, commercial, banking secrets, and other secrets protected by law, as well as other information in any form accessible to perception on any type of media, received in the exercise of their official powers, including information received when working with automated information subsystems, except for cases provided for by the laws of the Republic of Kazakhstan (L n. 474-II art. 15-13 n. 10 ARDFM). See also CP3, EC3.</p> <p>The employees are liable for the non-performance and improper performance of their duties and labor discipline in accordance with Law 475-II art 15-14 the ARDFM can impose disciplinary penalties to the employee in accordance with the Rules for imposing disciplinary penalties on the ARDFM employees (approved by Order № 441 of 30.10.2020).</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised. (b) salary scales that allow it to attract and retain qualified staff. (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks. (d) a budget and program for the regular training of staff. (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups. (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings re EC6	<p>ARDFM activities are financed from the republican budget (L. n. 475-II and Decree 203/2019, Art 11). While in theory this does not necessarily undermine its autonomy and operational independence, the assessors found actual constraints applied to ARDFM budget which negatively affect the compliance with this EC. When supervision was embedded in NBK, revenues from other business lines (for example,</p>

monetary policy) were used to fund the prudential oversight. With the new supervisory architecture, the ARDFM is fully dependent on the MOF, which decides on the ARDFM budget. The staff emphasized this is a negative consequence of the spin-off, which impinges on the ability to hire external experts and carry out appropriate cross-border work, including procurement of the IT solution necessary for the effective supervision. ARDFM does not levy fees on banks to build up its own budget.

The budget assigned to the ARDFM for 2023 amounts to 9.2 bln tenge (about \$US 20 mln) and it envisaged as constant until 2027.

Staff number and skill

The total staff size of the ARDFM (595 full-time employees) has been determined by Decree n. 203/2019 and approved by the President of the Republic of Kazakhstan. The resources assigned to the Banking Supervisor Department (n. 76) are divided as following:

BANKING REGULATION DEPARTMENT	Staff
Director, Deputy Directors	4
1.1. LICENSING	9
1.2. RESOLUTION OF PROBLEM BANKS	10
1.3. SUPERVISION OF GROUP II BANKS	13
1.4. COUNTERACTION TO UNFAIR PRACTICES	11
1.5. BANK INSPECTION	13
1.6. SUPERVISION OF SYSTEMICALLY IMPORTANT BANKS	16
Total	76
BANKING ANALYTICS AND STRESS-TESTING DEPARTMENT	30
Director, Deputy Director	2
1.1. BANKING SECTOR DEVELOPMENT AND ANALYTICS	10
1.2. BANKING STRESS TESTING	10
1.3. BANKING REPORTING AND STATISTICS	8

The ARDFM views is that resources are limited to conduct effective oversight, but that they are skilled and with good expertise. There are two Divisions responsible for off-site supervision:

- the Domestically Important Banks (D-SIBs) Division supervises n. 3 D-SIBs, n. 4 large banks and one bank with foreign ownership. The ARDFM appointed a representative in each of these 8 banks. The representative (also called "curator") has an average experience of 5 years and plays a crucial role on the supervisory cycle (CP8, EC3).

	<ul style="list-style-type: none"> the Division of group II banks oversight the remaining 13 banks, the Post Office and 4 organizations specialized in agriculture and mortgages. As these 4 organizations do not collect deposits from the public, their supervision could be moved to the Department of non-banking organization. <p><u>Salary scale.</u></p> <p>The terms of remuneration are approved by the Board (L' 474-II art. 6.5 and Decree 203/2019 Chapter 3 n. 14). Employee salaries are paid from the budget funds in accordance with the unified system of salaries for employees for all bodies, approved by the Government of the Republic of Kazakhstan in coordination with the President of the Republic of Kazakhstan. In its self-assessment the ARDFM expressed the view that salaries are comparable to the average salaries in financial institutions; wages are competitive and have been tested through vacancy processes. Moreover, wages are not indexed to inflation and, in a country where inflation runs at two digits (more than 20 percent), this reduces the staff real disposable income.</p> <p>The Chair sets official individual salaries for individual employees with high professional qualifications, who effectively and at a high level perform especially important, complex work. The Chair should ensure gender balance in the recruitment and promotion of the ARDFM's employees (decree n. 203/2019).</p> <p><u>External experts</u></p> <p>Although not prohibited by the legislation, the use of external experts is quite rare, mainly due to budget limitations. The 2019 internal desk-based AQR of the banking sector assets was the unique case of use of outside experts.</p> <p><u>Training</u></p> <p>The ARDFM's budget contains separate items for staff training (see EC7).</p> <p><u>Technology budget</u></p> <p>The tools, information systems, and architecture used in supervisory activities mainly belong to the NBK which serves as an entry point for collecting regular reporting data (credit registry) to minimize reporting burden for market participants. NBK grants access to ARDFM. Although, the ARDFM implemented a few advanced tools related to the internal desk-based AQR and stress testing, overall, the IT solutions for supervision (SupTech tools) require further upgrade. ARDFM needs to actively develop and use 4G SupTech tools based on technologies like: Artificial Intelligence (AI) and Machine Learning (ML), network analytics, Natural Language Processing and other.¹⁵ Implementation of these tools are critical to ensure effective RBS in long-term, but will require considerable financial investments which are not available currently.</p> <p><u>Travel budget</u></p> <p>The ARDFM's budget contains separate items of expenditure for business trips, including international trips. Overall, the travel budget is limited, and the ARDFM pointed out that this limits its capacity to participate in supervisory colleges or conduct cross-border examinations.</p>
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¹⁵ After the end of the FSAP mission, the ARDFM communicated plans to develop these technologies.

EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill sets identified.
Description and findings re EC7	The ARDFM prepares an annual plan to improve the training and qualifications of employees, considering the needs of each division and assessing the available skills, short- and medium-term needs of staff, practices, and objectives. The ARDFM shared its plan for advanced training and retaining employee: in 2022 it included training on NPL management and resolution, cybersecurity, systemic risk, macroprudential policy and stability analysis, FinTech, household finance, Reg-Tech, risk-based supervision, IFRS 9, analysis based on credit register data, corporate governance, operational risk management. They are organized in virtual mode by other Central Banks with potential unlimited number of participants. For the years ahead, interesting training is envisaged on limitation of risks associated with consumer lending using macroprudential instruments, development of the "green" economy, cross-border cooperation, AML/CFT.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	<p>Law 474-II art. 3 requires ARDFM to concentrate supervision resources on the areas of the financial market most exposed to risks to maintain financial stability (in the same vein, Decree 203/2019 art. 14 point 3). Thus, the distribution of resources should follow a risk-based approach and with consideration of systemically important banks.</p> <p>Pursuant to NBK Resolution n. 240/2019, n. 3 Domestically-Systemically Important Banks (D-SIB) have been identified, based on the methodology described under CP8, EC6. The ARDFM allocated n. 13 employees to the Division concerned. In each D-SIB, ARDFM appointed a representative ('curator') who is responsible for ensuring the implementation of the control and supervisory functions (CP9, EC7)</p> <p>Along with the size and complexity, also the risk profile plays a role in the allocation of resources. The supervisory strategy assigns staff in accordance with the risk rating system of the banks, which is based on an evaluation of quantitative and qualitative indicators of the financial condition of the banks. This rating system is used for the off-site analysis and inspection planning. The ratings assigned by an off-site supervision of the bank affect the frequency and subsequent full-scale inspections at the bank.</p>
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	<p>The Law provides legal protection to staff acting in good faith, but the staff is not protected against the cost of defending. In practice, there have been no instances of providing protection for ARDFM personnel.</p> <p>Pursuant to Art. 15-14 par. 7 L. 474-II <i>'The authorized body provides legal protection for its employees, members of the Management Board, including former employees and members of the Management Board, and persons involved by it in case of filing</i></p>

	<p><i>claims against them in connection with actions (inaction), decision made in the performance of their functions, including during the period when they perform their duties as members of provisional administrations and liquidation commissions of banks, insurance (reinsurance) companies, branches of banks-non-residents of the Republic of Kazakhstan, branches of insurance (reinsurance) companies-non-residents of the Republic of Kazakhstan</i>'.</p> <p>Moreover Article 922 of the Civil Code provides for provisions on liability to citizens and legal entities for damage caused by state bodies and their officials. In accordance with paragraphs 1 and 3 of Article 922 of the Civil Code, damage caused as a result of the issuance of acts by state bodies that do not comply with legislative acts is subject to compensation on the basis of a court decision, regardless of the fault of the bodies and officials that issued the act. The damage is compensated at the expense of the state treasury. The harm caused by illegal actions (inaction) of officials of state bodies in the field of administrative management is compensated on a general basis (Article 917 of the Civil Code) at the expense of the money at the disposal of these bodies. In case of their insufficiency, the harm is compensated subsidiarily at the expense of the state treasury. At the same time, the state body that compensated for the harm has the right of a retroactive claim (recourse) against the official whose illegal actions (inaction) caused harm. In practice there were no cases of compensation by the ARDFM for damages for illegal actions of its employees, respectively, and the right of recourse was not applied in the activities of the ARDFM.</p> <p>In addition, when challenging the action of the supervisory authority in court, the court must refuse to satisfy the claim if, during its consideration, it is established that the decision of the administrative body was made in accordance with the competence and legislation of the Republic of Kazakhstan (Administrative Procedural Code, Art. 155, par 4).</p> <p>Although the law provides legal protection to staff for actions taken and/or omissions made while discharging their duties in good faith, the ARDFM does not have in place a procedure to protect staff against the cost of defending (choosing a lawyer, representation of interests in court by the legal service, anticipation or reimbursement of legal protection expenses born by the staff, cooperation with the staff involved in the claim filled by third parties, assistance in providing materials and information, etc.).</p>
Assessment of Principle 2	Materially non-compliant
Comments	<p>ARDFM independence is not enshrined in the legislation, but rather undermined by several provisions in the Law 474-II which makes the ARDFM directly subordinated to the President of the Republic of Kazakhstan and confers to him the power to approve the organizational structure and the total staff (EC1) of the Supervisor (art 6-1 and 6-2). There is a lack of transparency in the process of removal of the governing body, as grounds for removal are not provided by the law, implying that the Chair can be removed for reasons others than those in EC 2. Moreover, there is no duty to publicly disclose the reason(s) for removal (EC2). One representative from the President of the Republic of Kazakhstan is a member of the ARDFM's Board.</p>

	<p>The system of financing, which makes ARDFM dependent on the republican budget, while not per se detrimental in general, in the specific case of ARDFM threatens its autonomy, as it impinges on the ARDFM's ability to carry out supervisory functions: hire external experts, carry out appropriate cross-border work on-site inspection, supervisory college), develop and maintain its proprietary IT system (EC6). Finally, while the Law provides legal protection to staff acting in good faith, staff is not protected against then cost of defending.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Law 474-II should be amended to prescribe the ARDFM independence, as well as its autonomy to decide organizational structure and number of staff. • The Law should also state that the ARDFM Chair could be removed only if not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reasons for removal should be publicly disclosed. • The representative from the President of the Republic of Kazakhstan in the ARDFM's Board should not have voting right. • The ARDFM may consider alternative solutions for building up its own budget, e.g., by levying fees to banks (and other supervised entities) calibrated to their assets or risk weighted assets. • The ARDFM should adopt a procedure to protect staff against the cost of defending themselves for actions and/or omissions made while discharging their duties in good faith (choosing a lawyer, representation of interests in court by the legal service, anticipation or reimbursement of legal protection expenses born by the staff, cooperation with the staff involved in the claim filled by third parties, assistance in providing materials and information, etc.).
Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ¹⁶
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>The Law on State Regulation (L. 474-II, Art. 15, para. 2) provides that the Agency shall coordinate its activities with other state bodies within the competence provided by the legislation of the Republic of Kazakhstan.</p> <p>Most prominently, the Agency is a member of the Council for Financial Stability of the Republic of Kazakhstan (FSC). The FSC was originally established by Presidential Decree Number 220 on December 18, 2010, to promote financial stability and advise the president; its role was strengthened in 2019 through interdepartmental coordination across multiple government agencies. The members of the Council are the chairman of the National Bank of the Republic of Kazakhstan, who serves as the</p>

¹⁶ Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).

	<p>Council's chairman, the Deputy Head of the Administration of the Republic of Kazakhstan (or the Assistant of the President in charge of socio-economic issues), the Chairman of the Agency on Regulation and Development of the Financial Market, and the Minister of National Economy.</p> <p>Beyond its broad mandate to promote financial stability, the FSC participates in joint measures of the NBK, the government, and must be consulted to resolve insolvent banks or to finance "second tier" banks when necessary, including when the NBK wishes to offer support.</p> <p>In addition, the NBK, Agency, and the Astana Financial Services Authority (the regulator of the Astana International Financial Center) signed a tripartite Agreement on Exchange of Information in May 2020 to cooperate in the supervision of financial markets in Kazakhstan, to promote financial stability, and to protect consumers.</p>
EC2	<p>Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.</p>
Description and findings re EC2	<p>As the legal successor of the National Bank's supervisory function, 44 agreements on the establishment of bilateral and multilateral relations with regulators and financial institutions of other countries were handed over to the Agency. Among them, 35 agreements provide for interaction on banking regulation issues, 24 on securities market regulation issues and 22 on insurance market regulation issues. The Agency conducted a review of all legacy agreements and determined that only one MOU with a jurisdiction in the region needed to be updated, which the Agency is currently doing.</p> <p>Although the Agency has these agreements in place, it does not necessarily share information with home country supervisors. The Agency supervises only a small number of local operations owned by firms headquartered in other jurisdictions. In at least one case involving two firms from the same foreign jurisdiction, the staff reported that the banks themselves asked to share the Agency's inspection reports with their home country supervisor, to which the Agency consented. In those cases, the staff said it was not necessary for the Agency to share the reports with the home country supervisor since the banks had committed to doing so.</p> <p>Still, according to Banking Law, Art. 50, par. 10, Law on State Regulation Art. 15, par. 4, and paragraph 220-1 of the Manual of Control and Supervision, the Agency and the National Bank have the right to exchange with the control and supervisory authorities of other states, international and other organizations, information necessary to implement the control and supervisory functions, on the basis and in accordance with international treaties, the contract providing for the exchange of confidential information, subject to the principle of confidentiality.</p> <p>The Agency provides information obtained in accordance with international treaties of the Republic of Kazakhstan to other state bodies of the Republic of Kazakhstan, as well as to organizations specified in Art. 15, par. 4 on the conditions provided by this article.</p> <p>The Agency has indicated it will cooperate with the control and supervisory authorities of other states, international and other organizations and has the right to exchange confidential information, constituting a commercial secret in the securities</p>

	market, banking secrecy, insurance secrecy or other secrets protected by law, necessary for the implementation of control and supervisory functions, based on and in accordance with international treaties of the Republic of Kazakhstan, the agreement providing for the exchange of confidential information.
EC3	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	<p>According to Article 4 of the Agency's Rules on handling confidential information, confidential information is information (data) related to the Agency's activities, management, finances, technological procedures, the disclosure of which may cause material, moral or other damage to the Agency or jeopardize the performance of tasks and functions assigned to the Agency in accordance with the law.</p> <p>The confidential information of the Agency may include banking and commercial secrets, confidentiality of personal deposits and savings, insurance and pension savings, personal data, as well as information the category of which is not legally defined.</p> <p>Article 38 of the Confidential Information Handling Rules stipulates that draft contracts (agreements, memorandums) providing for the transfer of information included in the List of Information Subject to Protection at the Agency shall be approved by the cybersecurity unit. The cybersecurity unit undertakes this work to ensure that any electronic means for sharing confidential information contains appropriate safeguards.</p> <p>In addition, the Agency is also subject to the protection of proprietary information, including information of limited distribution marked "confidential".</p> <p>According to paragraph 44 of the Procedure for Handling Information of Limited Distribution, the transfer of documents and publications marked "confidential" to foreign legal (natural) persons and their representatives is allowed in each individual case only with a written permission of the Agency's Chairperson or a person performing his/her duties.</p> <p>Therefore, taking into account Article 15 of the Law on State Regulation, the exchange of confidential information with state bodies of Kazakhstan or with regulators of other countries is possible in compliance with, among other things, the Rules of circulation of confidential information and the Procedure for handling information of limited distribution.</p> <p>Banking Law Art. 50, par. 10, the Law on State Regulation Art. 15, par. 4 and, and the Guidelines on Control and Supervision par. 220-1, outline the right of the Agency and the National Bank to exchange confidential information with the control and supervisory authorities of other states, international and other organizations. This exchange of information must be conducted in accordance with international treaties of the Republic of Kazakhstan, and subject to the principle of confidentiality.</p>
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another

	<p>supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>
Description and findings re EC4	<p>In accordance with the Law on State Regulation Art. 15 par. 4, the Agency cooperates with the control and supervisory authorities of other states, international and other organizations, and has the right to exchange confidential information constituting a commercial secret of the securities market, banking secrecy, insurance secrecy or other secrets protected by law. This exchange must be necessary for the implementation of control and supervisory functions on the basis of, and in accordance with, international treaties of the Republic of Kazakhstan, where the agreement provides for the exchange of information between the Agency and other organizations.</p> <p>The other organizations specified in part one of this paragraph shall mean the Astana Financial Services Authority, associations of central banks, control and supervisory bodies of other states, established for the purpose of development of unified standards for regulation of the banking sector, securities market and insurance market.</p> <p>According to Banking Law, Art. 50, par. 10, part three the Agency and the National Bank provide information received in accordance with international treaties or agreements that permit the exchange of confidential information, to other state bodies only with the consent of the party that provided such information originally.</p>
EC5	<p>Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.</p>
Description and findings re EC5	<p>Because the resolution authority is housed within the ARDFM, supervisors are well positioned to support resolution authorities and leverage the ARDFM's existing working relationships, including with the central bank. Consequently, the structure of the ARDFM and the resolution authority are aligned for cooperation and collaboration.</p> <p>The Agency, as a regulator, is authorized to resolve insolvent banks with minimization of systemic consequences and state losses, including insolvent bank resolution tools—transfer of assets and liabilities (R & A) and forced restructuring of insolvent bank liabilities (bail-in). (Banking Law Art. 61-7)</p> <p>State participation in the resolution of an insolvent bank is permitted if:</p> <ul style="list-style-type: none"> the insolvent bank poses systemic risks to the financial system; and the provision of state support will allow for the effective application of measures to resolve the insolvent bank. (Banking Law, Art. 61-8.5) <p>State intervention in the resolution of an insolvent bank is carried out after the bank has absorbed losses drawing on its own capital and has undertaken a forced restructuring of liabilities to its creditors that are not connected to the bank by special relations (Art. 61-10.1).</p> <p>Decisions for public authorities to intervene in the resolution of an insolvent bank that poses system risk implications for the financial system are the responsibility of the Council on Financial Stability of the Republic of Kazakhstan, created by the President of the Republic. Recommendations are submitted to the Council</p>

	<p>concerning the appropriate measures to take with regard to the bank (such as “bail-in” decisions) as well as the state’s involvement in the resolution.</p> <p>In order to protect the interests of bank creditors and ensure sustainability of the banking system, if the measures applied by the authorized body do not lead to the improvement of a bank’s financial condition, Banking Law, Art. 17-2 permits the Government to support the solvency of banks that are not yet recognized as insolvent, but whose financial condition has not improved after the application of appropriate measures. In this case, the Government has the right (at the suggestion of the Agency) to acquire or have the national holding management company acquire shares of the bank in the amount necessary to improve its financial condition and the bank’s compliance with prudential standards and (or) other mandatory standards and limits.</p> <p>Previously, the government did decide to provide public support to banks in response to the significant holdings of nonperforming loans in 2017. At the time, this decision was made as a Resolution of NBK which authorized the issuance of subordinated debt to relevant banks within the framework of the Program to Improve Financial Stability of the Banking Sector (approved by Resolution № 129 of the Board of the National Bank of June 30, 2017).</p> <p>Note that, at the time of the assessment, no requirements existed yet in Kazakhstan for supervised banks to create resolution and recovery plans. This is addressed in Core Principle 11. In addition, Kazakhstan’s current approach to the resolution of troubled banks is the subject of another workstream and was evaluated in that work more thoroughly.</p>
Assessment of Principle 3	Compliant
Comments	Kazakhstan maintains laws and regulations that provide for collaboration and cooperation between domestic authorities responsible for banking supervision, recognizing the importance of confidentiality. The ARDFM houses the resolution authority and as such is well-positioned to ensure collaboration and cooperation between supervisors and the resolution authority. The involvement of the representative from the President of the Republic of Kazakhstan in the Agency’s Board is addressed in CP1. The Agency’s engagement with foreign supervisory authorities is assessed in CP 13 regarding home-host relationships.
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	According to BL 2444 Art. 1 a bank is ‘ <i>a legal entity which is a commercial organization, entitled to perform banking activities in accordance with this Law</i> ’. The official status of a bank is determined by the state registration of the legal entity as a bank in the State Corporation “Government for Citizens”, as well as by the license from the authorized body (ARDFM) to conduct banking business.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.

Description and findings re EC2	<p>BL 2444 Art. 30 identifies the permissible activities of domestic banks and branches of foreign banks (non-resident banks).</p> <p>In addition to banking operations, banks might carry out additional services (for example, leasing, factoring, forfeiting, fiduciary operations), subject to ARDFM license (Art. 30, par. 11). They can be entitled to also perform security activities (broker, dealer, custodian and transfer-agent activities), if authorized by ARDFM (Art. 30, par. 12).</p> <p>To obtain a license for conducting additional banking and other operations, bank must (i) ensure compliance with prudential standards for three consecutive months prior to applying for a license; (ii) ensure adequate risk management and internal control systems (iii) submit the rules and procedures for conducting additional types of banking operations (BL 2444 Art. 26, par. 3).</p>
EC3	<p>The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.</p>
Description and findings re EC3	<p>Pursuant to BL 2444 Art. 1 par. 3 <i>“No legal entity that does not have the official status of the bank, may be called a ‘bank’ or describe itself as the entity engaged in banking activities.”</i> Moreover, no person who does not have an appropriate license from the authorized body has the right to carry out the banking transactions; use in its name, documents, announcements and advertising the word “bank” or a word/expression derived from it, giving the impression that it is performing banking operations. Banking operations carried out without a banking license are invalid (BL 2444 Art. 6, par. 1 n. 2 and 3).</p> <p>In addition, BL 2444 Art. 15 regulates the name of the bank. A bank must use the name specified in its charter as its name. The name must contain the word “bank” or its derivative word. All banks, except for NBK, are prohibited from using the words “national,” “central” in their names in full or in abbreviated form. All banks are prohibited to use the word “state” in its name in full or abbreviated form. The name of an Islamic bank shall contain the phrase “Islamic bank.” It is prohibited to use names that are identical or similar and may be mixed with the name of the previously established banks. Subsidiary banks shall use the name of the parent banks in their name.</p>
EC4	<p>The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.¹⁷</p>
Description and findings re EC4	<p>The taking on of deposit from physical person and legal entities is a banking activity performed by banks (art. 30 par. 2 let a) and b). However, legal entities other than banks can carry out the taking on of deposits from <u>legal entities</u> within the limits, imposed by the Laws of the Republic of Kazakhstan (art. 30, par. 6-1).</p> <p>The taking on of deposits from physical person is reserved to licensed banks that are members of the obligatory deposit insurance system, as well as to the National Post (BL 2444 art. 30 par. 13).</p>

¹⁷ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	The list of banks, including branches of foreign banks, is published on the ARDFM website.
Assessment of Principle 4	Compliant
Comments	The law defines the term “bank” and the permissible activities, enabling banks to carry out additional services and securities activities, subject to ARDFM authorization. The use of the word “bank” and any derivations is limited to licensed banks, whose list is published in the ARDFM website. The taking on of deposits from individuals is reserved to licensed banks, but the taking on of deposit from legal entities does not follow into these reserved activities.
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ¹⁸ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	ARDFM is responsible for granting and withdrawing banking licenses. The agency can impose limitations on the newly licensed bank, specifying the operations permitted (BL 2444 Art. 26). There have not been license applications since 2009. Two microfinance institutions initiated a dialogue with the Agency for a possible transformation in bank.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or

¹⁸ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	<p>The ARDFM has the appropriate authority to license banks and set and apply criteria for the process. BL 2444 art. 19-27 regulates the banking license process. The first step is the permission to open a bank; the second step is the license for carrying out banking operation. The two phases are designed to enable the Agency to conduct its own due diligence and the applicants to implement the organizational and technical measures (IT, personnel, etc.) needed before starting banking operations.</p> <p>Criteria for Licensing: Permission to open a bank</p> <p>The application to open a bank must be submitted in Kazakh or Russian languages and should include: the minutes of the constituent assembly; information about the founders (individuals and legal entities with a share in the capital of the bank of less than ten percent) including their audited financial statements; information needed to obtain the status of major participants; documents confirming the conditions and procedure for the acquisition of shares as well as sources and means used to acquire shares; business plan, financial prospects budget, balance sheet, profit and loss account for the first three financial operating years), marketing plan and plan for attracting labor resources and organizing risk management; documents of the persons proposed for the positions of bank executives; documents confirming the registration of the legal entity; document confirming the presence of the bank in the location where the executive board is located, with centralized access to the automated information system (art. 17, 19, 26).</p> <p>ARDFM may request additional information (art. 19).</p> <p>Fit and proper requirements for the executive employees of the bank and bank holding company are prescribed by Art. 20 (EC 7).</p> <p>The application must be considered by the Agency within sixty-five working days from the date of submission (art. 23).</p> <p>ARDFM might reject the application. For example, refusal to issue a permission to open a bank (Art. 24) can be motivated by:</p> <ul style="list-style-type: none"> • non-compliance with the provision concerning the bank’s name provided by Art. 15 (CP4 EC3) • instability of the financial position of the founders argued from the same signs highlighted by Art. 17-1 for major participants (see CP6) • outstanding or unexpunged conviction of the founder • inadequacy of the business plan to confirm (i) profitability after three years, (ii) compliance with requirement to limit risks and to establish an appropriate management structure, (iii) adequate organizational structure, and (iv) accounting and control structure in line with the planned activities. <p>The Agency is guided by ARDFM Resolution n. 36/2020. Then the application can be submitted through the portal. Within 10 (ten) working days from the date of registration of the application, the Agency checks the completeness of the submitted documents. The Agency verifies electronically the information related to criminal records, registration of legal entities etc. and, before issuing a refusal, provides the</p>

	<p>applicant with a preliminary decision, as well as hearing. A draft resolution on permission or refusal is then sent to the Board.</p> <p>Licensing of Banking</p> <p>Within one year from the date of issue of permission to open a bank, the applicant is obliged to complete all organizational and technical measures, including preparing the premises, equipment and software for automating accounting and the general ledger that meet the requirements of the regulatory legal acts of the Agency and NBK, hire appropriate personnel, approve the rules for banking and other activities, as well as the regulations on the internal audit service and credit committee, and contact the Agency to obtain a license to conduct banking and other operations.</p> <p>The bank must ensure the presence of its own premises in the location where the executive board is located, with centralized access to the automated information system.</p> <p>The application must be considered by the Agency within thirty working days from the date of submission of documents that meet the requirements of the national legislation. The Agency issues a license or a reasoned refusal within 30 working days from the date of receipt of documents confirming the state registration of a legal entity.</p> <p>A license is perpetual—e.g., for an unlimited period and not transferable to third parties. The decision is posted on the ARDFM website. A copy of the license must be placed in a place accessible for viewing to the bank’s customers (Art. 26 par. 6, 7, 8, and 10).</p> <p>Grounds for refusal (Art. 27) to issue a banking license include: the suitability of the major shareholder (EC5); failure to comply with prudential standards and other mandatory standards and limits within six months prior to the application submission; inconsistency of the size, composition, and structure of the authorized capital with the requirements of Art. 16; and non-compliance with the fit and proper requirement by the executive employees.</p> <p>However, there are no grounds in the legislation which enables ARDFM to revoke a bank’s license which was released based on false information.</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	Although not explicitly stated in the law, the licensing criteria are broadly consistent with those applied in ongoing supervision. This can be inferred by the grounds for refusal (EC2).
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ¹⁹ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	The Agency assesses the managerial structure in the context of the fit and proper test of executive employees (see EC7).

¹⁹ Therefore, shell banks shall not be licensed (Reference document: BCBS paper on shell banks, January 2003).

	<p>As regard the operational structure, within one year after issuance of the permit to open the bank, the applicant shall implement all organizational and technical measures, including preparation of premises, equipment, and software for automation of accounting and general ledger, complying with requirements of regulatory legal acts of the Agency and NBK. This is a condition to obtain a license to conduct banking operation.</p> <p>In relation to the ownership structure, “major participants” and “significant participants” are subject to prior authorization. (CP 6). Banks and bank holding companies submit quarterly to ARDFM the list of major participants with the amount of their allotted shares in the authorized capital of the bank as well as their percentage (BL 2444 art. 17-1, par 19). However, shareholders who own less than 10% of the bank’s shares are not required to notify the Agency. At the same time, the Agency receives information about all bank shareholders, including minority shareholders from the depository/central registry.</p>
EC5	<p>The licensing authority identifies and determines the suitability of the bank’s major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.</p>
Description and findings re EC5	<p>ARDFM assesses the suitability of the bank’s major shareholders and others physical or legal person that may exert significant influence, as well as the sources of initial capital and ability of shareholders to provide additional financial support, where needed.</p> <p>Suitability of Major participants</p> <p>BL 2444 art. 2 par. 6 defines ‘major participant’ as an individual or legal entity which own directly or indirectly <u>ten or more percent</u> of the shares of the bank or is able to:</p> <ul style="list-style-type: none"> • vote directly or indirectly with ten percent or more of voting shares of the bank. • influence the decisions made by the bank by virtue of the agreement or otherwise in the manner determined by ARDFM regulatory legal act. <p>BL 2444 Art. 17-1 requires ARDFM <u>prior authorization</u> to own, use or dispose of ten percent or more of the bank’s share, or to exert the control or influence the decision made by the bank (see CP6, EC2). ARDFM authorization to become a major participant is a condition to obtain banking license (Art. 19, par. 1, n. 4). Art 17-1 spells out the documentation which must be submitted to obtain the consent for acquisition of the status of a major participant, distinguishing between (i) physical person, (ii) resident legal entity, and (iii) non-resident legal entity.</p> <p>(i) A <u>physical person</u> must submit:</p> <ol style="list-style-type: none"> 1) copies of documents confirming the conditions and procedure for the acquisition of shares, including <i>sources and means used to acquire shares</i>. These sources must be (i) income, received from business, labor or other paid activity; (ii) documented savings and (iii), up to twenty-five percent of the value of the purchased shares, money received as a gift, winnings, or income from selling the gratuitously received property (with

	<p>information about the grantor, and the source of origin of such property of the grantor).</p> <ol style="list-style-type: none"> 2) information on legal entities in which the individual is a major participant. 3) the bank's recapitalization plan in case of a possible worsening of its financial condition. 4) information on income and property, outstanding debt, and declaration on assets and liabilities notarized or certified by the state revenue body, no older than thirty calendar days prior to the date of submission of the application, accompanied by supporting documents sufficient to analyze the financial situation of the applicant. 5) information about the applicant including education, labor activity, "impeccable business reputation." Non-resident individuals submit a document confirming the absence conviction issued by the relevant state body of the country of their citizenship. 6) a written confirmation by the relevant state body of the country of residence of a non-resident individual that the acquisition of the shares of a Kazakhstani bank is permitted by the national legislation or a statement of the authorized body that such permission is not required under the legislation. 7) a document confirming payment of the fees. <p>(ii) A <u>resident legal entity-resident</u> must submit:</p> <ol style="list-style-type: none"> 1) a copy of the decision of the relevant body on the acquisition of the bank's shares. <ol style="list-style-type: none"> 1-1) information and supporting documents on persons who, alone or jointly with others, own, directly or indirectly, ten or more percent of the shares of the legal entity, or have the ability to determine its decisions by virtue of an agreement or have control. 1-2) a list of the applicant's affiliates. 2) information and documents specified in subparagraphs 1), 2), 3) and 7) related to the application submitted by individuals. 3) notarized copies of constituent documents. 4) brief data on the applicant's top executives, including information about education, labor activity, and "impeccable business reputation." 5) annual financial statements for the last two financial years, certified by an auditing organization, and financial statements for the last quarter before the submission of the application. <p>A <u>non-resident legal entity</u> must submit:</p> <ol style="list-style-type: none"> 1) documents specified in subparagraphs n. 1), 2), 3) and 6 related to the application submitted by physical person and 1), 1-1), 1-2), 3), 4) and 5) related to the application submitted to a resident legal entity 2) information about its credit rating assigned by one of the international rating agencies recognized by the Agency 3) a list of legal entities in which the applicant is a major participant 4) a written confirmation from the home Supervisory that the applicant is authorized to perform financial activities, or a statement that such permission is not required in the home country.
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A non-resident financial institution subject to consolidated supervision in the country of its location is entitled to be a bank holding company directly owning twenty-five percent or more of the share or voting rights of a domestic bank. To obtain permission to acquire the status of a bank holding, a non-resident financial institution shall submit:

1) the information and documents referred to in paragraph 6 of this Article.

1-1) a written confirmation from the Financial Supervisory Authority of the country of location of the applicant that the non-resident financial institution—shall be subject to the consolidated supervision.

1-2) a written permission (consent) of the Financial Supervision Authority of the country of the location of the applicant or a statement that such permission (consent) is not required.

2) written confirmation from the Financial Supervisory Authority of the country of origin of the applicant that the applicant is authorized to perform financial activities under the legislation of this country, or a statement such permission is not required. The individuals, wishing to acquire the status of a major participant of the bank with the ownership interest of twenty-five or more, as well as the legal entity wishing to acquire the status of a bank holding company, in addition to the documents and information referred above, shall also submit a five-years business plan.

If an individual or legal entity began to meet the characteristics of a major participant without the Agency's prior consent based on a donation agreement or a trust management agreement, they should present:

- copies of documents related to the donation or trust management.
- the documents indicated in subpar. n. 2), 3), 4), 5), 6) and 7) related to the application submitted by individuals.
- information on the value of shares donated or conferred into the trust, determined by an appraiser.

To obtain the consent: (i) the value of the property (excluding the value of previously acquired shares of the bank) owned by an individual on the right of ownership shall not be less than the total value of the shares that are the subject of the gift agreement and the shares of the bank previously acquired by it; (ii) income, received from entrepreneurial, labor, or other paid activity of an individual, as well as his/her monetary savings, make up not less than seventy-five percent of the value of donated shares of the bank, determined by the appraiser.

Impeccable business reputation

Pursuant to Resolution n. 189/2019 art. 13, when assessing the business reputation, the Agency should consider facts and circumstances related to:

- 1) criminal responsibility against person, property, in the field of economic activities, for corruption and other criminal offenses against interests of state service and state administration.
- 2) participation as an accused or defendant in criminal proceedings in connection with criminal offenses against person, property, in the field of

	<p>economic activities, for corruption and other criminal offenses against the interests of the state service and state administration.</p> <p>3) violations of the requirements of the legislation of the Republic of Kazakhstan or the legislation of another state regulating the professional activity in which the person was (is) engaged.</p> <p>4) fulfillment of the requirements of international professional standards applied in the Republic of Kazakhstan, in terms of ethics and exclusion of conflicts of interest.</p> <p>5) recognition as insolvent of a legal entity in which the person was an official and/or a major shareholder within 2 (two) years after the termination of the powers.</p> <p>6) termination of a labor agreement at the initiative of the employer for negative reasons.</p> <p>7) provision of misleading information or refusal to provide such information.</p> <p>Financial situation</p> <p>When assessing the financial situation of a founder, the Agency considers:</p> <ul style="list-style-type: none"> • unexecuted court decision on debt collection on the date of filing an application in relation to an overdue of more than 100,000,000 (one hundred) million tenge. • restructuring of obligations due to the deterioration of financial situation. • application of accelerated rehabilitation, rehabilitation, or insolvency procedures. • individual accused or defendant in criminal proceedings for offenses against a person/property, in the field of economic activities, for corruption or other criminal offences against interests of the state service and the state administration. • lack of property and (or) money sufficient to ensure additional capitalization of the bank. • the ratio of legal obligations to equity capital which should not be more than 5 (five) for physical person, or more than 10 (ten) for a financial institution. <p>ARDFM can exert "motivated judgment" when assessing the "<i>unstable financial situation</i>" or the "impeccable business reputation" which implies technical discretion (see CP 8).</p> <p>Banking Law does not define ultimate beneficial owners. However, according to the Law of the Republic of Kazakhstan of August 28, 2009, No. 191-IV "<i>On Counteracting the Legalization (Laundering) of Proceeds from Crime and the Financing of Terrorism</i>" (AML/CFT Law), a beneficial owner is a natural person:</p> <ul style="list-style-type: none"> • who directly or indirectly owns more than twenty percent of the shares in the authorized capital, or the shares placed (minus the preferred and redeemed by the company) of the client—a legal entity or a foreign structure without the formation of a legal entity.
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	<ul style="list-style-type: none"> • exercising control over the client in a different way. • in the interests of which the client makes transactions with money and (or) other property. <p>Agency staff argued that this definition can be used for licensing purposes.</p>
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	<p>According to paragraphs 2,3 of the Decree № 170 the minimum size of the authorized and own capital for the newly established bank is set at 10 000 000 000 (ten billion) tenge.</p> <p>The minimum size of the bank's own capital shall be set in the following order:</p> <ul style="list-style-type: none"> • for the housing construction savings bank in the amount of 4,000,000,000 (four billion) tenge. • for other banks in the amount of 10 000 000 000 (ten billion) tenge. <p>Considering the restriction on the <i>sources and means used to acquire shares</i>, the initial disbarment cannot be done with assets other than cash. These assets cannot be borrowed. The Agency assesses the financial situation of the founders, including their leverage and credit history (EC5).</p>
EC7	<p>The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.²⁰ The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.</p>
Description and findings re EC7	<p>BL Art. 20 prescribes requirements for the <u>executive employees</u> of the bank and a bank holding company. Executive employees are the <i>"heads and members of the management body, as well as executive body, other heads carrying out coordination and (or) control over the activities of structural subdivisions of the bank and having the right to sign documents on behalf of the bank."</i></p> <p>The Agency emphasized that it does not have the power to assess the suitability of the Heads of internal control functions (CRO, Chief Compliance Office, Chief Internal Audit Officer etc.), because the definition of "executive employees" focuses on those <u>who have the right to sign business transactions</u>. ARDFM also expressed concerns on a few cases of banks with inadequate Chief Risk Officer that the Agency could not prevent from taking such a position.</p> <p>A person cannot be appointed (elected) as the bank's executive employee if he/she:</p> <ol style="list-style-type: none"> 1) lacks higher education. 2) lacks work experience in international financial organization, or provision/regulation of financial services or audit services of financial organizations.

²⁰ Please refer to Principle 14, Essential Criterion 8.

	<p>3) has not "<i>impeccable business reputation</i>:" existence of the facts confirming professionalism, reliability, absence of unexpunged or outstanding criminal conviction, including absence of the court decision depriving the right to occupy the position of an executive employee/major participant (major shareholder) of financial organization <u>for life</u>.</p> <p>4) has served as head/member of a management body/executive body, chief accountant of a financial institution, head/deputy head of a branch of a non-resident bank, insurance/reinsurance company-non-resident or insurance broker-non-resident, a major participant, within a period not more than one year prior to the supervisor making the decision to classify the bank/branch of a non-resident bank <u>as insolvent</u>, on the conservation of the insurance/reinsurance, or forcing the buyout of its shares, revoking the license, liquidating or terminating the activities in the financial market, or the court decision on the forced liquidation of the financial organization, or its declaring bankrupt, forcing termination activities of a branch of a non-resident bank or an insurance (reinsurance) company. This requirement applies within five years after making the decision by the competent authority/court.</p> <p>5) the supervisory consent to the appointment/election to serve as executive has been revoked. The requirement applies within the last twelve consecutive months after the decision by the authorized body.</p> <p>6) has committed a corruption offence or who has been brought to disciplinary responsibility for committing a corruption offence within three years prior to the date of appointment (election) may not be appointed (elected) as an executive employee of the bank.</p> <p>7) has served as head/member of the management body/ executive body, chief accountant of a financial organization, major participant of a legal entity <u>defaulted</u> in the payment of coupon interest for four or more consecutive period or for an amount exceeding a threshold determined by the law. This requirement applies within five years from the default.</p> <p>The Agency clarified that these criteria are assessed by checking internal and external databases, criminal records and questionnaires which must be attached to the application. This questionnaire also contains a list of business interests of the founders and candidates for the Board of directors/management board position, to enable the Authority to verify potential conflict of interests.</p> <p>A candidate for the position of senior employee of the bank is not entitled to perform the relevant functions without the ARDFM consent.</p> <p>A member of the bank's Board of directors has the right to perform the relevant functions without the ARDFM consent for no more than sixty calendar days from the date of his/her election.</p> <p>ARDFM can refuse the consent in case of:</p> <ul style="list-style-type: none"> • negative test result (less than 70 percent of correct answers) or failure to appear for testing (ARDFM clarified that quite a few candidates fail this test). • availability of information (facts) that the candidate was a party of the transaction committed for the purpose of manipulation in the securities market, and (or) caused damage to a third party. This applies for <u>one year</u> from the
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	<p>recognition by ARDFM of the transaction or the receipts of facts confirming the damages.</p> <ul style="list-style-type: none"> • availability of information that the candidate was an employee of a financial organization, in respect of which ARDFM has applied supervisory response measures and (or) imposed an administrative penalty for manipulating the securities market (Article 259 of the Code of the Republic of Kazakhstan on administrative offense) and/or an executive employee or a trader of a financial organization, whose actions caused damage to the financial organization and/or third parties involved in the transaction. This applies for <u>one year</u> from the recognition by ARDFM of the transaction or the receipts of facts confirming the damages. <p>In the case of the ARDFM refusing to grant consent for the appointment (election) of a member of the bank's Board of Directors or his powers have been terminated before the issuance of this consent, or if the required documents are not submitted to the ARDFM for approval within sixty calendar days, this person may be reappointed (elected) to the position of a Board member for the same bank. However, this reappointment can occur no earlier than ninety calendar days after receiving the refusal from the ARDFM to grant consent for his appointment (election) or after the termination of his powers, and no more than twice within a twelve-month period.</p> <p>The bank is obliged to notify the Agency within five working days from the date of the decision of the relevant body of the bank of all changes that have occurred in the composition of senior employees, including their appointment (election), transfer to another position, termination of the employment contract and (or) termination of authority to bring a senior employee to administrative responsibility for committing a corruption offense, and also about changes in the surname, first name, patronymic (if it is indicated in the identity document) of the senior employee with copies of supporting documents attached.</p> <p>If a senior employee of the bank is brought to criminal responsibility, the bank notifies the Agency within five working days from the day when this information became known to the bank.</p> <p>ARDFM can revoke the consent in case of (i) identification of false information based on which the consent was issued; (ii) application of supervisory response measure of the "suspension from performing duty" (Art. 46 par. 1, sub-12); (iii) presence of unexpunged or outstanding criminal conviction. In the event of revocation of ARDFM consent, the bank is obliged to terminate the employment contract with this person or, in the absence of an employment contract, to take measures to terminate the powers of this executive employee.</p>
EC8	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.²¹</p>

²¹ Please refer to Principle 29.

Description and findings re EC8	<p>According to BL 2444 Art. 19, applicant should submit the business plan, financial prospects, marketing plan, a plan for attracting labor resources and organizing risk management; documents of the persons proposed for the positions of bank executives.</p> <p>As regards internal controls related to the detection and prevention of criminal activities, the Agency pointed that prior to the commencement of banking activities, the applicant is obliged to complete all organizational measures, including the approval of the regulations on the internal audit service. Nevertheless, it does not seem there is a specific focus on this aspect and the lack of power to approve the Heads of internal control function might weaken the analysis concerned.</p> <p>Resolution 2019/188 states that in the case of outsourcing external contractors to carry out certain operations and/or business processes, the board of directors of the bank shall ensure the existence of effective principles and practices for managing risks arising from the involvement of external contractors (CP24 EC8).</p> <p>No licensing file was examined to test evidence of implementation, because the last banking license was issued in 2009.</p>
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	Among the documentation that applicant should submit are financial prospects: budget, balance sheet, profit, and loss account for the first three financial operating years. Moreover, the instability of the financial position of the founders is grounds for refusal (Art. 24). In addition, the assessment of the financial situation of the major participant (art. 17-1) is an integral part of the authorization process (CP6).
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	<p>From December 16, 2020, it is permitted to open branches of foreign banks (before that date only subsidiaries).</p> <p>Before launching its activities within the territory of the Republic of Kazakhstan, a foreign financial institution shall obtain a permit to open the branch from the Agency. Afterwards, the foreign branch shall have the right to obtain the appropriate license of the Agency to start operating in the financial market of Kazakhstan. The parent company shall provide the branch with enough assets accepted as a reserve placed on the terms of an irrevocable deposit with the National Bank (10 billion Tenge). To open a foreign branch, a foreign bank shall have a minimum amount of assets at the level of US \$20 billion. A branch of the foreign bank shall have the right to accept deposits from individuals in the amount of US\$ 120 thousand in equivalent and deposits from legal entities - without restrictions.</p> <p>BL 2444 art. 21 provides for additional requirements to establish a bank with the participation of nonresident individuals or legal entity which are founders. A written confirmation from the home supervisory that the applicant is authorized to perform financial activities, or a statement that such permission is not required is envisaged (EC 5). The Agency asks the home supervisor for confirmation that the non-</p>

	residential legal entity is subject to consolidated supervision. However, the ARDFM does not assess the quality of the home supervisor consolidated supervision.
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	ARDFM assesses new entrants' ability to achieve their business and strategic objectives during the annual SREP when analyzing the "Business Model" component. The Agency examines the bank's achievement of stated goals and priorities by comparing the development strategy, forecast budget with actual indicators. If inconsistencies are identified, the bank's rating is reduced, which, accordingly, entails the application of supervisory response measures and onsite inspections with the requirement for the bank to bring its activities in line with the stated goals.
Assessment of Principle 5	Largely Compliant
Of Comments	<p>There have not been license applications since 2009; therefore, files were not reviewed during the assessment. Nonetheless, the regulatory framework is deficient as:</p> <ul style="list-style-type: none"> the Agency does not have the power to conduct fit and proper tests on the Heads of internal control functions (CRO, Chief Compliance Office, Chief Internal Audit), because they do not fall under the definition of "executive employees" as per art. 20 Banking Law n. 2444 (EC5). Such a definition focuses on those who have the right to sign business transactions and the Agency expressed concerns on a few cases of banks with inadequate Chief Risk Officer that it could not prevent from taking such a position. <p>The assessors acknowledge that, even though a condemnation for corruption affects the suitability only for three years, the Agency has the power to exert motivated judgement on the impeccable business reputation.</p> <p>Recommendations</p> <p>Banking Law should be amended to:</p> <ul style="list-style-type: none"> enable the Agency to carry out the F&P test on the Heads of internal control functions. refer to AML/CFT Law for the definition of "beneficial ownership."
Principle 6	Transfer of significant ownership. The supervisor ²² has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest."

²² While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

Description and findings re EC1	<p>Under the Banking Law, Art. 2, the Agency relies on the following definitions in exercising its authority:</p> <ul style="list-style-type: none"> • control—under the law, control exists when an entity is able to “determine the decisions” of another legal entity. The law outlines four conditions, only one of which needs to be met to control another entity. These conditions are: <ul style="list-style-type: none"> (1) the “direct or indirect possession by one entity alone or together with one or more entities of over fifty percent of the shares in the authorized capital or the allotted shares (net of the preferred and those repurchased by the company)” or the ability to vote on one’s own or with others more than fifty percent of the shares. (2) the ability to elect “at least half of the governing body or the executive body of the legal entity.” (3) the “inclusion of financial statements of the legal entity,” with one exception addressed below; or (4) the ability “to determine the decisions of the legal entity by virtue of a contract” or under other circumstances described in regulation. <p>An exception to the third condition above exists in the law that excludes special financial companies established under laws related to project financing and securitization whose financial statements are otherwise included in a consolidated entity. A topic related to this subject—namely the asset management companies established to hold troubled assets—is addressed further in the assessment of CP 18 on problem assets, provisions, and reserves.</p> • Significant participation in the capital is defined in the law as the “possession, directly or indirectly, alone or together with one or more entities, of twenty or more percent of the voting shares” (stakes in the charter capital) or the “ability to vote 20 or more percent of the shares.” <p>Although the Banking Law does mention the concept of “beneficial owners” in a discussion of what constitutes a non-resident (Paragraph 6-5.1), the law does not define what a “beneficial owner” is, nor does it address the concept of an “ultimate beneficial owner.” As beneficial ownership and especially the identification of the ultimate beneficial owner of a company or counterparty is a significant concept in the Core Principles (see CP5, EC5), it would be useful to identify a definition that applies in the case of establishing or transferring ownership over a licensed bank. Agency staff indicated that a definition of beneficial owner does appear in the AML/CFT related law (Article 1.3), which indicates that holders of 25 percent or more of shares should be considered beneficial owners. ARDFM staff reported that this definition can be applied for applications and acquisitions. However, this is not stated in the banking law or in the AML/CFT law. The authorities should clarify this definition in the context of licensing of banks and changes in ownership.</p>
EC2	<p>There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.</p>

Description and findings re EC2	<p>The Banking Supervision Department is responsible for evaluating proposed changes in ownership of a bank. The banking law sets out a variety of notification requirements to seek approval for various levels of holdings of a bank's outstanding shares. While the term beneficial owner is not defined explicitly for transfers of significant ownership, laws and regulations related to anti-money laundering do offer a definition based on holding 25 percent or more of a bank's shares.</p> <p>A person or entity that receives approval to hold more than ten percent of bank's outstanding shares results is considered a "major participant of a bank" (Art. 2-6). A person or entity that receives approval to hold more than twenty-five percent of a bank's outstanding shares is considered a "bank holding company" (Art. 2-4). Consequently, the notification requirements described below for "major participants" would likely capture a larger set of owners than the AML law's definition of beneficial owner and capture at least the equivalent of beneficial owners as defined in some other jurisdictions.</p> <p>With regard to becoming a major participant of the bank, the Banking Law (Art. 17-1.1) stipulates that "no person independently or jointly with another person may directly or indirectly own, use and (or) dispose of ten percent or more of the outstanding shares of the bank, as well as to have control or the ability to influence decisions made by the bank in the amount of ten percent or more of the outstanding shares of the bank without prior written consent of the authorized body."</p> <p>If a person meets the definition of a bank holding company without having received approval of the authorized body, the banking law prohibits the person from taking "any actions...aimed at influencing the management or the policy of the bank" or to vote shares "until it receives a written consent from the authorized body in accordance with the provisions of this Article" (Art. 17-1.16).</p> <p>When a person or entity becomes aware that it meets the definition of a bank holding company (such as by acquiring 25 percent or more of outstanding shares), the Banking Law requires that person to submit an application to the Agency to receive written consent to continue to hold those shares. An exception exists for those who plan to dispose of their shares, in which case the holder of the shares must notify the Agency of its intentions to sell those shares immediately upon reaching that decision. (Art. 17-1.16).</p> <p>The law furthermore requires that a major participant in the bank or a bank holding company (for example, someone who owns more than 10 percent of outstanding shares) notify the Agency of any increases in the number of shares held, including "identifying the source of funds used to purchase the bank's shares." For decreases in the number of bank shares held by a major participant in a bank or a bank holding company to less than 10 percent or 25 percent, respectively, the authorization that the Agency had previously issued to be a major participant or a bank holding company, respectively, is considered cancelled. Increases above twenty-five percent held by an individual must additionally submit to the Agency a business plan based on requirements issued by the Agency (Art. 18).</p>
EC3	<p>The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If</p>

	<p>the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.</p>
Description and findings re EC3	<p>The banking law empowers the Agency to reject proposals to make changes in significant ownership; however, assessors did not see evidence that the ARDFM can restrict the exercise of voting rights. Under Article 17-1, the Agency has the power to define the rules for both granting and revoking consent to become a major participant in a bank or a bank holding company. The transparency mandated in this process is reflected in the requirement that the Agency must respond within fifty working days after the application is received (Art. 17-1.14), the response must be in writing and, when refusing permission, the grounds for denying the application must be explained in the written response (Art. 17-1.14).</p> <p>If the ARDFM determines that it granted consent for a change in significant ownership based on inaccurate information, it may reverse the change in ownership within two months of detecting the inaccurate information (Art. 17-1.15).</p> <p>If the Agency declines to consent to an entity becoming a bank holding company or a major participant of the bank, the entity must reduce its holdings below the level of a bank holding company or major participant depending on the status the entity had sought (Art. 17-1.15, with a similar requirement expressed in Art. 11-10).</p> <p>While beneficial ownership is not defined for transfers of significant ownership, as noted under EC2 existing laws and regulations in Kazakhstan do define "major participants" in a bank as entities that hold 10 percent or more of the bank's outstanding shares and "bank holding companies" as entities that hold more than 25 percent of outstanding shares. Consequently, ARDFM's power to reject proposals for changes in ownership would likely apply to a larger set of owners than under the definition of beneficial owner in the AML law and the equivalent of beneficial owners in some other jurisdictions.</p>
EC4	<p>The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.</p>
Description and findings re EC4	<p>Each quarter, banks and bank holding companies are required to report a list of all major participants or bank holding companies to the Agency and their percentage of ownership (Art. 17-1.19). Changes in the composition of shareholders that own more than ten percent of outstanding shares must also be reported to the Agency within fifteen days of those changes occurring (Art. 17-1.19).</p> <p>Essential criterion 4 furthermore requires supervisors to have the ability to obtain information from banks about the identities of others whose shares may be held by others. The Banking Law empowers the Agency to seek information from individuals or legal entities when information exists that the individual or entity meets the conditions or a banking holding company or major participant of the bank. (Art. 17-1.17) However, the law does not address beneficial owners specifically. While the Law on Banks does not define "beneficial owner," Agency staff indicate that a definition available in the AML/CFT Law, can also be used for licensing purposes.</p> <p>As stated under CP5, EC, AML/CFT Law (Art. 1.3) defines beneficial ownership.</p>

	Because the concepts of “beneficial owner” and “ultimate beneficial owner” are important throughout the Core Principles, it would be useful to define this concept in the banking law or associated regulations directly or to explicitly refer to the definition in the relevant AML law.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	<p>As noted above in the assessment of EC2, the banking law states that if a person becomes a bank holding or a large participant in a bank without obtaining prior written consent from the authorized body, it is not entitled to take any actions aimed at influencing the management or policy of the bank, and (or) vote on such shares until it receives written consent from the Agency in accordance with the provisions of this article.</p> <p>In this case, the person who corresponds to the characteristics of a bank holding company or a large participant in a bank is obliged to notify the authorized body within ten calendar days from the moment it became aware that it corresponds to the characteristics of a bank holding or a large participant in a bank.</p> <p>If the Agency declines to authorize a person or entity to become a major participant or a bank holding company, the person or entity must reduce the number of shares owned below the level of the authorization sought.</p> <p>Details and legal citations regarding the process for notifying the ARDFM about transfers of ownership may be found in the assessment of EC 2 above.</p>
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	<p>Large shareholders of banks and banking holdings provide regular reports to the Agency that characterizes the financial condition of the shareholder:</p> <ul style="list-style-type: none"> • for legal entities, the frequency of reporting is quarterly. • for individuals, the frequency of reporting is yearly. <p>Under Banking Law Art. 45-1.1, the Agency is empowered to “apply supervisory response measures” to the bank itself as well as to its bank holding companies, major participants of the bank, or “persons possessing the characteristics of a major participant of the bank or a bank holding company.” It may do so to protect “legitimate interests” of a bank’s key stakeholders, such as depositors and creditors, and to protect the financial stability of the bank or the banking group. The grounds for applying supervisory responses include actions taken by major participants or bank holding companies that could cause the bank damage or unstable conditions of the major participant or the bank holding company, among other grounds (Art. 45-1.2).</p> <p>To comply fully with this EC, the law or relevant regulations should specify that banks are required to notify the Agency of any material information that affects the suitability of a major shareholder.</p>
Assessment of principle 6	Largely Compliant
Comments	Relevant laws and regulations define control and significant participation clearly. While the AML/CFT law addresses the concept of a beneficial owner and staff believe it can be used to cover investments, it would be useful to clarify that this term may

	<p>indeed be used in such circumstances. It is also important for relevant laws and regulations to indicate clearly that the ARDFM is authorized to approve or reject changes in significant ownership, including changes to beneficial owners of a firm.</p> <p>Assessors did not see evidence that the ARDFM has the ability to suspend voting rights for changes in significant ownership that it opposes; the legislation should explicitly assign this authority to the ARDFM.</p> <p>Finally, laws or regulations should more clearly require banks to notify the Agency of any material information that affects the suitability of a major shareholder, such as a major participant or a bank holding company.</p>
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	<p>Laws or regulations clearly define:</p> <p>(a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and</p> <p>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.</p>
Description and findings re EC1	<p>(a) Under Banking Law Art. 8, par 1 and 2, banks and bank holding companies may not transact in "entrepreneurship activity" that is not related banking activity or acquire capital or shares of non-commercial organizations, with limited exceptions. The main exceptions give banks and bank holding companies the ability to participate in the National Chamber of Entrepreneurs of Kazakhstan and to purchase bonds issued by international financial institutions as well as bonds issued by special financial companies owned by banks or bank holding companies; neither of these exceptions appears to contradict CP 7.</p> <p>Acquisitions equivalent to ten percent or more of the bank's own capital require supervisory approval. Under Banking Law Art 8, para. 4, the acquisition by a bank of shares in the authorized capital or shares specified by the Law on Commercial Banks must not exceed ten percent of the bank's own capital for one legal entity. This restriction applies to the bank's ownership of shares in the authorized capital or shares of these legal entities, including in cases of their creation. The aforementioned restriction does not apply to banks in connection with the acquisition of control over another bank (1) in relation to which a restructuring has been carried out, and (2) that carried out an operation simultaneously transferring assets and liabilities between a parent bank and a subsidiary bank.</p> <p>The total value of the bank's investments in the authorized capital or shares of legal entities should not exceed 50 (fifty) percent of the bank's own capital.</p> <p>The acquisition and ownership by the bank of ten or more percent of the shares or participation interests in the statutory capital of financial organizations, as well as legal entities that are non-residents of the Republic of Kazakhstan and have the</p>

	<p>status of banks, insurance organizations, pension funds, professional market participants of securities, are allowed provided that the bank meets additional requirements for minimum capital adequacy established by a normative legal act of the Agency. This requirement applies in the case of the bank creating the aforementioned legal entities.</p> <p>(b) Banks are not required to seek permission from the Agency to create or acquire subsidiaries in certain cases and must only notify the Agency within fourteen working days of the acquisition or investment. (Art. 11-1.1) The cases exempted from prior Agency approval concern the acquisition of bank holding companies that indirectly own the bank's shares through ownership of a bank holding company that directly owns the shares of the bank (Art. 8-13.2).</p> <p>Shareholders who own less than 10 percent of the bank's shares are not required to notify the Agency. At the same time, the Agency receives information about all bank shareholders, including minority shareholders from the depository.</p>
EC2	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	<p>B.L. Art 8 sets out both prohibitions on transactions that banks and bank holding companies may undertake as well as criteria they must meet to make acquisitions in permissible entities.</p> <p>B.L. Art. 11-1 establishes the requirements for obtaining a preliminary approval by banks and bank holding companies in the cases of: Acquiring a significant participation in the capital of companies (Art. 11-1, par. 11). Significant participation in the capital is defined as the possession of twenty or more percent of voting shares (stakes in the authorized capital), directly or indirectly, alone or jointly with one or more persons or the presence of possibility to vote with twenty percent or more of the shares (subparagraph 12) of Article 2; Acquisition of a subsidiary (i.e., 50 percent or more in equity) of the banks and bank holding companies (Art. 11-1, par. 1).</p> <p>The factors evaluated in determining to approve/deny an application include an applicant's capacity in risk management and internal controls to manage the acquisition; the adequacy of the applicant's capital; the financial condition of the acquiring bank; and the impact of the acquisition.</p>
EC3	<p>Consistent with the licensing requirements, an expectation among the objective criteria is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.²³ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.</p>

²³ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

Description and findings re EC3	<p>When granting approvals, the Agency conducts an assessment of the potential impact of the proposed transaction on the financial situation of the bank, the expected effect of the transaction, and the consequences of a large transaction.</p> <p>Under B.L. Art. 11-6, the reasons for denying permission to create or acquire a subsidiary, among others, include a failure to address the Agency’s comments on its application; noncompliance with legislation prescribed for consolidated supervision; a group’s failures to comply with prudential standards; an indication that the transaction could weaken the financial condition of the bank or bank holding company; noncompliance with the Agency’s risk management and internal control system requirements; the existence of supervisory response measures or administrative penalties; or the reporting of “unprofitable activity” of the bank or bank holding company during each of the preceding two fiscal years prior to submitting the application.</p> <p>For cross-border acquisitions, the Banking Law requires the applicant to provide an analysis of the legislation of the host country where the subsidiary is located indicating the “absence of circumstances” that would make it possible for the Agency to conduct consolidated supervision because the members of the banking group in that jurisdiction would not be possible to comply with the requirements of the laws of the Republic of Kazakhstan (Art. 11-4.6).</p>
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	<p>In order to obtain consent to make an acquisition or investment, B.L. Art. 11-5 requires that the bank must have “break even” activity on a consolidated and unconsolidated basis in each of the past two fiscal years. The bank must also have complied with the Agency’s prudential standards. As noted above in the assessment of EC 3, grounds for denying permission include the bank’s failure to comply with the Agency’s requirements for risk management and internal controls or that the acquisition/investment may weaken the financial condition of the bank or its group.</p> <p>The Agency confirms the bank’s compliance with these requirements by requiring insight into</p> <ul style="list-style-type: none"> • the constituent documents of the subsidiary (Art. 11-4.1). • information on the senior management of the subsidiary or candidates (Art 11-4.3). • the business plan of the subsidiary (Art. 11-4.5). • the financial reporting of the subsidiary being acquired (Art. 11-4.8).
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	<p>Until 2022, there was a legislative ban on non-core activities of banks and their subsidiary organizations. As of 2022, staff report that the following types of activities have been legally permitted for bank investments:</p> <ul style="list-style-type: none"> • fintech technologies; and • the development and implementation of software.

	According to Agency staff, investments in the shares of these organizations may account for more than 15 percent of a bank's capital if the bank complies with heightened requirements for risk-weighted assets (RWA 1250 percent).
AC1	The supervisor reviews major acquisitions or investments by other entities in the banking group to determine that these do not expose the bank to any undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ²⁴ Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.
Description and findings re AC1	
Assessment of Principle 7	Compliant
Comments	The Banking Law gives the Agency sufficient authority to approve or reject applications for major acquisitions and to impose prudential conditions on those acquisitions. Assessors reviewed examples of internal documentation and saw reasonable analyses drafted by ARDFM staff.

Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: <ul style="list-style-type: none"> (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system. <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
Description and findings re EC1	In 2019 the Agency transitioned to Risk-Based-Approach (RBA) and the supervisory methodology for assessing nature, impact, and risk of banks is based on the Risk Assessment System (RAS) approved by the Agency Chairperson's Decree dated 06.08.2020 № 317K. The RAS feeds into the Supervisory Review Examination Process (SREP; see EC2), which has been complemented by the internal desk-based Asset Quality Review (AQR) and the Stress Testing.

²⁴ Please refer to Footnote 23 under Principle 7, Essential Criterion 3.

	<p>The Supervisory Manual</p> <p>The assessors went through some selected chapters of the supervisory manual. It prioritizes the area of supervisory actions and the level of oversight intensity based on the results of the analysis and on the risk assessment system.</p> <p>Risk-Based Approach (RBA)</p> <p>Law n. 474-II art. 15-8 prescribes that the authorized body applies a risk-based approach (RBA) in the framework of control and supervision over the activities of banks, to identify and prevent risks, intervene at an early stage, and take timely actions to ensure their financial stability. One of the principles of supervision should be the efficient use of resources and their concentration in the area most exposed to risk (art. 3 par. 2, n. 1 and 3). Accordingly, the RBA implemented by the ARDFM takes into account banks' systemic importance, as the authority identified D-SIBs and allocated one representative to each of them, thus fostering a higher intensity of supervision; by contrast, for no-D-SIB banks a single ARDFM representative oversees more than one banks. The role of the ARDFM representative is explained under CP9, EC3.</p> <p>The RBA leverages on the motivated judgment formed on quantitative and qualitative analysis of the bank's activities and their risk management and internal control systems, including an analysis and assessment of the business model, corporate governance, AML/CFT risk, the level of capital and liquidity.</p> <p>RBS takes also into account the principle of proportionality, namely size, significance, nature, scale, and complexity of banks' activities; categorization according to their importance in the financial market; determining the frequency, depth and intensity of control and supervision.</p> <p>The motivated judgement</p> <p>Law 474-II art. 13.5 states that the Agency has the right to exert a motivated judgement in relation to five areas:</p> <ol style="list-style-type: none"> 1) <u>Licensing</u>: <ul style="list-style-type: none"> • assessment of the "<i>impeccable business reputation</i>" of (i) a candidate to the position of an executive officer of a bank/bank holding company and, since 2022, also during the term of his/her appointment;(ii) an executive officer of a banks/bank holding company subsidiary or a company where a bank/bank holding company have a significant participation; (iii) an applicant for the position of major participant of a bank/bank holding company, • assessment of "<i>unstable financial situation</i>" of the founder of the bank, and an applicant acquiring the status of a major participant in a bank/bank holding company. 2) <u>Related parties' transaction</u>: determining the persons who are recognized as "persons associated with special relations with the bank" (a related party) and determining transaction with preferential terms (see CP20). 3) <u>Risk management and internal control system</u>: assessing the quality of risk management and internal control in a bank and a banking group. 4) <u>Provisioning</u>: assessing the adequacy of reserves of a bank. 5) <u>Major participant</u>: determining the persons who are (jointly) major participants in the bank.
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	<p>The restriction to these five areas is also confirmed by Decree n. 203 Chapter 2 n. 15 which states that the Agency applies a <u>risk-oriented approach</u>, including using motivated judgment "<i>in cases provided for in Article 13-5, paragraph 2 of the Law (474-II).</i>"</p> <p>A motivated judgement is used in compliance with principles of legality, validity, objectivity, and a uniform approach. The Rules for formation and use of a motivated judgment (NBK Resolution n. 189/2019) provides for the procedure concerned. A motivated judgment is "<i>a professional opinion of the collegial body of the authorized body, which is the basis for application of supervisory response measures.</i>" A draft motivated judgment must be based on relevant and reliable information, essentially <u>facts</u>, and contain the explanation of the person to whom it is addressed, who should receive the draft within five days from its formation. The collegial body, considering all the documentation submitted, including the consent or disagreement of the person to whom it is addressed, can issue the motivated judgment, or reject the proposal submitted by the Agency's proponent office, due to lack or insufficient grounds for formation and use of a motivated judgment.</p> <p>The assessors examined two motivated judgments concerning (i) related party transactions and (ii) risk management internal control.</p> <p>The motivated judgement is the result of robust procedures which anchor supervisory discretion to facts, prevent circumvention of rules, and are respectful of defense rights (right to be heard, right to comments). However, limiting the motivated judgment to the five areas enucleated by the Law constrains supervisory discretion, which is an essential ingredient of RBA.</p> <p>Banking supervision is not an exact science. RBA is a principle-based, dynamic, and flexible concept. Certain terms (for example, '<i>ultimate beneficial owner</i>', '<i>group of connected clients</i>') should be interpreted by the supervisors on a case by case. The Agency might need to expand the areas of reasoned judgement, while strengthening the legal protection of its staff. At the same time, if there is the need to act urgently, the Agency should be able to exert a '<i>provisional motivated judgment</i>' providing the concerned party with the right to be heard <u>after</u> the decision is taken.</p> <p>Also, the Agency currently cannot adopt a '<i>provisional motivated judgment</i>', giving the persons concerned the opportunity to be heard as soon as possible after taking its decision. That would be an important complement to ARDFM's powers in those cases when urgent action is needed; for example, if the need arises to classify a borrower as a related party in order to prevent the bank from further lending.</p> <p>EC2 elaborates on risk assessment and SREP; CP9, EC1 and EC5 respectively on the internal desk-based AQR stress testing, two important tools of the Agency supervisory approach.</p> <p>It is worth highlighting that the descriptions under the following ECs of this CP mainly refer to 'banks' rather than 'banking groups', since consolidated supervision presents various shortcomings, which are detailed under CP12.</p> <p>There is no formal resolvability assessment, since ARDFM has not prepared resolution plans (see EC6).</p>
EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view

	of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	<p>The Supervisory Manual provides the methodology for conducting Risk Assessment System (RAS) which feeds into the SREP. One component of the SREP is business model analysis; moreover, the SREP is complemented by stress testing. Both business model analysis (see CP9, EC4) and stress testing provide a forward-looking view of banks' profitability drivers and risk profile (for a detailed description of stress testing see CP9, EC5).</p> <p>The Risk Assessment and the Supervisory Review Examination Process (SREP)</p> <p>SREP has been designed by external consultants and an international audit firm and is based on the Eurozone Single Supervisory Mechanism (SSM) framework. The risk assessment (RAS) is carried out by quantitative and qualitative analysis of information on four main areas: (1) business model, (2) risk to capital risks (credit, market, operational, and interest rate risks); (3) liquidity risk; and (4) corporate governance. At the end, banks are assigned with a final rating from "1" (low risk) to "4" (high risk). The final rating is communicated to the bank.</p> <p>Quantitative analysis (33 indicators) is carried out to assess the level of risk, including changes in the relative and absolute financial indicators of the bank, according to the submitted financial and regulatory statements and other parameters. Qualitative analysis (122 indicators) targets the level of risk management and internal control system, as well as external factors that may affect the bank's business profile.</p> <p>In 2021 for the first time, the Agency conducted a <u>full-scale assessment of banks using the SREP methodology</u>, and internal desk-based AQR and supervisory stress testing in a pilot mode.</p> <p>According to the SREP 2021 results, the main areas of improvements were:</p> <ul style="list-style-type: none"> • <u>Quantitative indicators</u>: high proportion of accrued interest income on loans that do not actually generate cash flows; increased level of non-performing assets (NPA); high level of related parties' loans, and concentration risk; increased loans to deposits ratio and concentration of funding sources. • <u>Qualitative indicators</u>: lack updated or officially approved capital adequacy plans in case of unforeseen circumstances and other shortcomings in the internal processes for assessing capital adequacy and liquidity; shortcomings in the processes of strategic and budget planning; imperfection of methods for determining risk appetite, including the failure to use the results of stress testing. <p>Based on 2021 SREP results, 6 banks were classified as "low risk," 11 banks with "moderately low risk," 4 banks with "moderately high risk," and 1 bank was classified as "high risk" (against 4 in 2020). These results were submitted to the Supervisory Committee, who approved the supervisory measures (letter, recommendations to eliminate risks and deficiencies, measures to improve the financial condition and (or) minimize risks, and the request of action plans).</p> <p>In 2022, based on the SREP exercise, seven banks were classified as "low risk," eight banks as "medium-low risk," five banks as "medium-high risk," and one bank was deemed to be "high risk."</p>

EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>ARDFM assesses the compliance of banks and banking groups with prudential regulations and other legislative requirements by analyzing the regulatory reporting. As regard banking group, CP12 elaborates on the limitations of consolidated supervision.</p> <p>The list, forms of reporting, the deadlines, and procedures for its submission to the NBK are established by normative legal acts of NBK in coordination with the Agency. The supervisory information systems belong to NBK, and the Agency is a user of the National Bank's systems.</p> <p>Chapter 18 of the Supervisory Manual focuses on "<i>verification of compliance with prudential standards and other mandatory norms and limits and recalculation of individual prudential standards.</i>" At the assessors' request, ARDFM made available a list of banks that were in breach of prudential requirements. As of February 2023, only one bank was breaching a prudential requirement (the large exposure limits); in January, the same bank had also breached the limits to open currency position.</p>
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>As regards the macroeconomic environment, see CP9, EC5 on stress testing.</p> <p>Non-banks financial institutions (NBFIs) do not appear to generate systemic risk; in any case, ARDFM is responsible for their supervision. The financial system is bank-centered, with banks holding 78 per cent of total financial asset and another 8 percent held by the Development Bank of Kazakhstan. The other actors of the financial system are:</p> <ul style="list-style-type: none"> • N. 2 mortgage companies, the National postal operator and 3 non-financial institution operating the field of agro-industrial complex) with total assets of amounted to 2,769.5 billion tenge (about 5 percent of banks' assets). • N. 27 insurance organizations (2 of which with 100 percent state participation) with total asset of 1.829 billion tenge (about 7 percent of banks assets). • 35 mutual investment funds, with total volume of assets under management amounted to just 483.3 billion tenge, just 1.2 percent of banking asset system. Collective investment schemes have not grown to a point where they could represent a risk to financial stability and only 1 out of 35 is open-end.
EC5	The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	An area where ARDFM noted that risk is building up is consumer lending . The Agency has been paying special attention to the accelerated growth of consumer lending which could have negative consequences for the stability of banks and

	<p>create conditions for the emergence of risks of social tension among borrowers. At the beginning of 2020, the growth rate of consumer loans reached 26.9 percent, therefore, some systemic measures were taken:</p> <ol style="list-style-type: none"> 1) a ban on the accrual of penalties and fees on unsecured consumer loans after 90 calendar days past due has been imposed at legislative level. 2) the Agency prohibited banks from issuing loans to citizens with incomes below the minimum cost of living, or where debtor's monthly total liabilities exceed 50 percent of his/her income (debt service to income ratio). 3) ARDFM tightened prudential requirements to consumer loans. <p>While in 2020 these measures restricted the growth of loans to individual (+13 percent), in 2021 the growth rate of consumer lending peaked at about 40 percent, significantly exceeded the growth in personal income, and contributing to the accumulation of the debt burden of the population. Loans to individuals include consumer and mortgage lending, which represent, respectively, 33.2 percent and 17.8 percent of total banking loans as at 1.1.2022. During the meetings, it was mentioned that certain banks adopt aggressive underwriting standards, for example by granting consumer lending to enable borrowers to make the down payment (20 percent on new mortgage or to repay overdue debt including with other institutions.</p> <p>In 2021, to assess the real number of citizens with bad debts, the Agency, together with NBK, banks, MFOs and collection agencies, reconciled data on all problem loans of the population.</p> <p>Thus, in total, <u>1.5 million unique borrowers with a total debt of 1.3 trillion tenge have problem loans in banks, MFOs and collection agencies.</u></p> <p>To curb the accumulation of risk stemming from aggressive lending to borrowers who do not have stable incomes, ARDFM further recalibrated risk weight for consumer lending which now range from 100 percent to 350 percent, depending on:</p> <ol style="list-style-type: none"> (i) the borrower's income, both official and unofficial but confirmed by certain statistical data (for example cash turnover on customer accounts), and (i) the interest rate on the loan—the higher the interest rate, the higher the capital requirements. <p>The efficacy of these prudential measures remains to be seen in the months ahead. As detailed under CP 17, there seems to be signs of loosening underwriting standards (CP 17).</p>
EC6	<p>Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.</p>
Description and findings re EC6	<p>ARDFM is the Resolution Authority. Pursuant to NBK Resolution n. 2019/240, the criteria to classify a bank as a domestically systemic importance (D-SIB) are: (1) size: (assets/liability); (2) interconnectedness (inter-banking assets/liabilities, individual</p>

	deposits guaranteed by the Deposit Insurance Funds); (3) interchangeability (role in the payment system, loan portfolio, custodian services); (4) complexity (derivatives, foreign currency, securities). The decision was taken by NBK and communicated to the bank and to the Agency. Although n. 3 D-SIB has been identified, the Agency has not prepared resolution plans; therefore, it has not assessed barriers to orderly resolution.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	<p>BL 2444 envisages the framework below for handling banks in time of stress.</p> <p>Triggers for early detection and mandatory recognition of problem banks are defined at the legislative level, as well as a deadline for raising the capital of such banks. Depending on the severity of their financial situation, problem banks are classified into two categories: (1) banks with unstable financial situation, and (2) insolvent banks.</p> <p><u>Banks with unstable financial situation</u></p> <p>According to Banking Law art. 61-6, the supervisor classifies a bank as a bank “with unstable financial situation,” creating a threat to the interests of its depositors and creditors and (or) a threat to the stability of the financial system in the presence of any of the following signs:</p> <ul style="list-style-type: none"> • a decrease in the values of the adequacy ratios of equity capital and its size to below the minimum values. • non-performance by the bank of monetary obligations and other claims of creditors of monetary character in connection with absence or insufficiency of money at the bank. • identification of facts (transactions), whose reliable reflection in financial or other reporting will lead to violation by the bank of its capital adequacy ratios and (or) non-performance of monetary obligations and other claims of creditors of monetary nature. • identification of deficiencies and (or) risks which may lead to creation of situation that threatens the stable functioning of the bank, and (or) interests of its depositors and (or) creditors, and (or) stability of the financial system. <p>This decision should be brought to the attention of NBK and of the Deposit insurance fund within five working days from its adoption. The bank cannot distribute profits, pay dividends, fulfill any financial obligations to major participants and (or) bank holding companies, as well as pay remuneration to the executive employees, except for salaries and cases, established by the legislation of the Republic of Kazakhstan.</p> <p>A bank classified “<i>with an unstable financial situation</i>,” its major participants, and the bank holding company are obliged to take measures to improve the financial status of the bank, minimize risks by bringing its activities in compliance with the legislation of the Republic of Kazakhstan and the supervisory requirements.</p> <p>A non-resident bank, whose branch is classified as a branch with an unstable financial position, is obliged to take measures to improve the financial condition of its branch, minimize risk by bringing its activities in line with the legislation of the Republic of Kazakhstan and the supervisory requirements. If these measures are</p>

	<p>insufficient, the non-resident bank shall fulfill the obligations not fulfilled and (or) improperly fulfilled by its branch.</p> <p>An action plan to improve the financial situation must be agreed with the bank's major participant, the bank holding company, a non-resident bank of the Republic of Kazakhstan. Terms of implementation of these measures should not exceed twelve months and may be extended once by the supervisor for a period of not more than twelve months if there are improvements in the financial status of the bank. In case of non-submission of the plan of measures to improve the financial situation within the established term, its disapproval by the supervisor, or the non-execution of the plan, ARDFM shall apply to the bank with an unstable financial situation, its major participants, a bank holding one or more supervisory response measures provided by Banking Law Art 45-1,</p> <p>Early intervention measures were recently used in the case of the crisis management of three banks (2020-2021). Banks and their major shareholders were required to take actions to improve the bank's financial condition. Following the nonfulfillment of the action plans and the presence of grounds for revoking licenses, two banking licenses were revoked and a third banks was classified as an insolvent bank. The early intervention framework should occur well before the breach of any regulatory requirement or threshold and work hand in hand with recovery planning requirements.</p> <p><u>Insolvent banks</u></p> <p>Pursuant to Banking Law Art. 61-7, the Agency classifies a bank as insolvent in case of non-elimination of the signs of unstable financial situation after the expiration of the term to implement the measures to improve the financial status. ARDFM has the right to classify a bank as insolvent before that term, on the following grounds:</p> <ol style="list-style-type: none"> 1. performance by the bank, after being classified as banks with an unstable financial situation, of operations that lead to further deterioration of its financial status, including: <ul style="list-style-type: none"> • conclusion of transactions which lead to a significant deterioration in the quality of assets. • conclusion of transactions at non-market conditions in which the bank incurs losses, as well as transactions with related party in violation of the concerned requirements and restrictions. • acceptance of obligations which have entailed the impossibility to fulfil, in full or in part, monetary obligations to other depositors and/or creditors. • transfer of property (including for temporary use) free of charge or at a price significantly below the price of similar property under comparable economic conditions, or without any reasons to the detriment of the interests of creditors. 2. reduction of the bank's equity capital adequacy ratios to a level by one- third below the minimum. 3. non-fulfillment within ten working days of monetary obligations and other claims of monetary nature to the depositors and or creditors in connection of absence or insufficiency of money.
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	<p>4. systematic (three or more times within twelve consecutive calendar months) improper performance of contractual obligations on payment and transfer operations.</p> <p>5. non-performance of measures to improve its financial status and/or minimizing risks, provided by Banking Law art. 46.</p> <p>The Resolution framework, which was amended in 2019, with the introduction of specific instruments to resolve failing banks, has not been fully tested in practice. Before this amendment, banking crises and resolutions were managed using old tools with frequent state intervention.</p>
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	<p>If the Agency becomes aware of activity that is fully or partially carried out outside the regulatory perimeter, the Agency has the right to forward this information to another competent government body (in practice, there have been cases of information being sent on financial pyramids to law enforcement agencies).</p> <p>When carrying out operations, transactions that fall outside the regulation of banks, the Agency may initiate legislative amendments clarifying the scope of regulation (in practice, amendments were made to the Banking Law and the Law on Joint Stock Companies).</p>
Assessment of Principle 8	Largely Compliant
Comments	<p>ARDFM has recently transitioned to RBA and its supervisory methodology for assessing nature, impact, and risk of banks is based on the Risk Assessment System (RAS), which feeds into SREP. In 2021, for the first time, the Agency conducted a full-scale assessment of banks using the SREP methodology, and internal desk-based AQR and supervisory stress testing in a pilot mode (CP9). Also benefiting from IMF technical assistance, ARDFM is working to further enhance RBA, namely developing a methodology for calculating the Pillar 2 add on, based on quantitative and qualitative parameters and stress test results.</p> <p>One key element of the RBA is the motivated judgement, that anchors supervisory discretion to facts, give the persons who are the subject of the proceedings the opportunity of being heard, and force the Agency to base its decisions only on objections on which the parties concerned have been able to consent or disagree.</p> <p>The motivated judgment is fully respectful of rights of defense and ensure the due process in adopting supervisory decisions. However, limiting the motivated judgment to the five areas enucleated by the Law constrains supervisory discretion, which is an essential ingredient of the RBA. Banking supervision is not an exact science. RBA is a principle-based, dynamic, and flexible concept. Certain terms (for example, "<i>ultimate beneficial owner</i>," "<i>group of connected clients</i>") should be interpreted by the supervisors on a case-by-case basis. The Agency might need to expand the areas of motivated judgement, while strengthening the legal protection of its staff. Moreover, the adoption of a motivated judgement might take time; if there is the need to act urgently, the Agency should be able to exert a "<i>provisional motivated judgment</i>" providing the concerned party with the right to be heard <u>after</u> the decision is taken.</p>

	<p>The Agency has not prepared resolution plans; therefore, it has not assessed barriers to orderly resolution.</p> <p>Recommendations</p> <p>Motivated Judgment</p> <ul style="list-style-type: none"> Expand to new areas the motivated judgement, which should become the ordinary <i>modus operandi</i> of the Agency. In case urgent action is needed (for example, classifying a borrower as a related party and preventing the bank from further lending), the Agency should be able to adopt a "<i>provisional motivated judgment</i>," giving the persons concerned the opportunity to be heard as soon as possible <u>after</u> taking its decision. The Agency might consider establishing an Administrative Board of Review for the purposes of carrying out an internal administrative review of the decisions taken in the exercise of the motivated judgment, after a request for review submitted by any natural or legal person to which the decision is addressed or is of a direct and individual concern to that person. <p>The Agency should conduct resolvability assessments.</p>
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site ²⁵ and off-site ²⁶ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	<p>The ARDFM deploys a combination of on-site and off-site surveillance processes for evaluating the banks' risk profile and internal control environment.</p> <p>Offsite Supervision</p> <p>The position of the ARDFM representative in a bank ('curator') is fundamental to the off-site supervisory process, as he/she provides a single point of contact between the ARDFM and the supervised banks, facilitates coordination and enables ongoing supervision. The participation, as an observer, of the ARDFM representative in the banks' collegial bodies is described under EC3. Under the current EC, it is worth highlighting that the curator carries out multiple activities at different frequency:</p>

²⁵ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

²⁶ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

- daily—monitoring of the quality of banks' loan portfolios (large loans, including to related parties, restructuring/refinancing).
- weekly—assessment of changes in balance sheet items.
- monthly—(i) changes in the main financial indicators (reviews of financial performance trends, and capital and liquidity position); (ii) checklists on fulfillment of certain requirements; (iii) analysis of activities which might lead to early intervention measures; (iv) monitoring of implementation of action plans (for example, measures to reduce NPLs, etc.), (v) monitoring of the flow of funds of large depositors.
- quarterly—monitoring of activities of subsidiaries acquiring doubtful and hopeless assets of the parent bank.
- annually— (i) analysis of the auditor's report on the bank's financial statements and of the auditor's recommendations; (ii) assessment based on SREP methodology (iii) evaluation of banks' exposure to AML/CFT risk.

The outcomes of these activities vary and include: reports commenting these changes in banks' balance sheet items; request of explanation to banks; proposals, if necessary, of supervisory actions (for example, onsite inspections); engagement with auditors to provide explanations; request to submit an action plan; letter to the Bank on acceptance/non-acceptance or adjustment of the Action Plan; memo on significant movements of depositors accounts; SREP report.

The assessors went through various notes prepared by the curator (analysis of audited financial statements, operations of distressed assets management companies, AML/CFT analysis, and other material events) and found an adequate reporting to the management, also after constructive interaction with the bank by the curator.

The coverage of offsite supervision goes beyond credit risk. First of all, as described under CP8, EC2, SREP includes other risk profiles: for example, the assessment of the **viability and sustainability of banks' business model** (see EC4). Moreover, the offsite supervision also conducts on a **quarterly basis** assessment of the **liquidity adequacy** of banks based on prudential indicators trends, loan portfolio growth rate, deposits outflows, assets and liabilities gap, and other info (see CP24, EC3). The reports are submitted to the ARDFM management and, if high risks are identified, the supervisory unit is requested to strengthen liquidity monitoring for these banks. Finally, other risks (such as market and operational risk) are also covered (see CP 22 and CP 25).

Since its inception, the ARDFM has invested on two tools to strengthen the off-site supervision: the **stress testing**, and the 'regular internal desk-based **AQR**' (which is described below). They both complement the SREP, whose outcome is to classify banks into four categories, depending on the rating (see CP8, EC2). Detailed regular desk-based AQR and stress testing results are provided to the Department of Banking Regulation; this contributes to determine the intensity of supervision, including the **specific mix of onsite and offsite supervision**.

The **on-site function** is incisive (for example, it discovered unreported related parties' transactions in banks which defaulted between 2020 and 2021). EC 2 elaborates on the on-site inspection planning and execution process.

	<p>The Banking Regulation Department assesses the quality and efficiency of its functions on a continuous basis and, in case of identification of areas requiring improvements, it includes into its annual Work Plan (for example, amends the Supervision Manual, Regulations, or modernization and automation of processes). However, there was no evidence of a formal process in place to assess the quality, effectiveness and integration of its on-site and off-site functions.</p> <p>The internal desk-based Asset Quality Review (AQR)</p> <p>ARDFM is progressively increasing the use of AQR, transforming it from an <u>exceptional on-site exercise</u> to a <u>regular off-site tool</u>. The internal desk-based AQR is carried out on IT proprietary system.</p> <p>In conjunction with the spin-off of supervision, NBK completed in 2020 an independent full-scale AQR of 14 major banks, selected based on their economic significance (in total 87 percent of the banking assets and 90 percent of loan portfolio). The AQR was based on international financial reporting standards and prudential regulation, and it aimed to achieve an objective and fair view of bank assets, as well as a reliable and fair assessment of capital adequacy.</p> <p>The AQR methodology envisages nine blocks: (1) Analysis of accounting processes, policies and practices; (2) Creating a loan form and verifying data integrity; (3) Forming a selection of portfolios; (4) Analysis of credit files (ACF); (5) Valuation of collateral; (6) Projection of ACF results; (7) Reservation analysis based on a collective assessment; (8) Analysis of assets measured at fair value, and (9) Determination of capital adequacy ratios adjusted for the results of the internal desk-based AQR.</p> <p>According to its results, as at of April 1, 2019, <u>there was no shortage of capital</u> both at the system level and at the level of individual participating banks. Nonetheless, areas of improvements were identified in the quality of processes, data, policies, and procedures:</p> <ul style="list-style-type: none"> • credit risk management—ensuring the "three lines of defense" model (including the independence of risk management), expanding the criteria and rules for determining "related parties" (CP20), and detailing the criteria for determining the "group of connection clients" (CP21), automating the storage of data from credit files and improving the requirements for the quality of information in credit files. • collateral—development of quality control processes for valuations of collateral and real estate. • business planning, budgeting and strategy development, calibration of risk appetite limits. • policies and accounting rules for hedging instruments—formalization of rules and criteria for classifying assets (amortized cost <i>versus</i> fair value), specification of criteria for the fair value hierarchy. <p>In April 2020, the Agency agreed on individual corrective action plans for the 14 AQR participating banks, with a deadline of execution until the end of 2023 (CP 11). The action plans provide for individual measures, aimed at eliminating specific violations/deficiencies, and general corrective measures, to improve business processes (planning, budgeting, risk appetite, etc.). In 2021, AQR banks continued to</p>
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work on the implementation of these action plans and ARDFM followed up through remote supervision and inspections of 6 banks (see CP9, EC7).

The Agency developed, implemented, and piloted a “**regular AQR.**” Based on the experience of the previous full-scale 2019 internal desk-based AQR, the regular AQR is carried out remotely and without the involvement of auditors, independent appraisers, and consultants. At the same time the Agency tries to maintain the statistical accuracy of the model within the specified ranges.

One of the key goals of a regular AQR is to automate the entire process of regularly assessing asset quality, using regulatory reporting from other databases. To that goal, the Agency, together with NBK, expanded regulatory reporting to include 21 key indicators of loans, contingent liabilities, and collateral. In 2021, the regular AQR methodology was tested in a pilot mode with the participation of a limited number of banks (n. 4). In 2022, regular AQR and supervisory stress-testing was conducted on 10 banks with 71 percent of banking sector’s assets. ARDFM prepared models for assessing the financial condition of banks’ borrowers, the credit risk parameters templates, and a tool to calculate the effect of the regular AQR on the capital adequacy. For each bank, an assessment of individually significant loans was carried out (those exceeding 0.2 percent of banks equity), including an analysis of collateral. Credit impairment stages and PDs of individually significant loans were determined using internal credit risk models. For other loans, analysis is performed in the block of analyzing homogeneous loans, which in turn is based on calculation of the probability of default (PD), the exposure at default (EAD), the loss given at default (LGD), and usage of credit limit by defaulted borrowers prior to default to calculate credit conversion factor (CCF) and EAD. To analyze homogeneous loans a statistical model was created using migration matrices to calculate PD and banks’ repayment statistics for defaulted/withdrawn/modified loans to calculate LGD. ARDFM assessed about 1,400 borrowers on an individual level and more than 19 million loans on a collective basis, determining the level of credit risk and assessing its effect on capital adequacy. As a result of the assessment in the 2022 internal desk-based AQR, the total capital adequacy of the banks included in the pilot AQR sample was reduced by 1.7 percentage points, confirming, according to the Agency, the efficiency of the AQR tools, which is serving as input for stress testing.

In principle, the AQR is not meant to be a regular tool. It is instead intended as a tool to be used in exceptional circumstances and to be run, possibly, by third parties, independent from both the banks and the supervisor, and to be conducted by specialized teams on-site at the banks.²⁷ For example, the ECB has made use of it (i) at the SSM inception (2014); (ii) where less significant institutions (LSI) migrate to the significant institutions (SI) and become subject to the SSM supervision and (iii) when new member states join the euro area (Croatia) or enter in close cooperation with the ECB (Bulgaria). Making the AQR a regular (annual) exercise may have some advantages, but it also has some limitations. One advantage of an annual desk based AQR is that it can help the Agency focus, in its offsite and (even more) onsite activity, on the banks and portfolios that appear to be more exposed to risks, based on the internal desk-based AQR; however, it must be clear, from this perspective, that the internal desk-based AQR is instrumental to the other activities: i.e., a mean to an end, not an end in itself. Another advantage could be related to the

²⁷ See also Moretti et al., [Managing Systemic Banking Crises: New Lessons and Lessons Relearned \(imf.org\)](https://www.imf.org/publications/fti/2020/01/Managing-Systemic-Banking-Crises-New-Lessons-and-Lessons-Relearned), IMF, 2020.

	<p>assessment of granular portfolios, as the small amount of the single loans would require a disproportionately labor-intensive on-site inspection process, with the risk of limiting the credit file review to a negligible percentage of the lending portfolio. By contrast, the reliability of AQR as a remote off-site tool could be limited for assessing individually significant loans which require extensive review of documentation and discussion with banks.</p>
EC2	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions</p>
Description and findings re EC2	<p>The Supervisory Action Program</p> <p>The Supervisory Action Program is the process for planning and executing on-site and off-site activities. It is developed by the off-site divisions, based on the SREP rating, the results of the last risk-based inspection, AML/CFT risk assessment, information on security risks in the banking sector, results of regular desk-based AQR, stress testing results, consumer complaints, supervisory actions taken against the bank in the last twelve months, time period since the last inspection, bank's petitions, business indicators (projected business growth), complexity/systemic importance of the bank, information on changes in the bank's management team and structure, and other information.</p> <p>The offsite Divisions follow the below principles when preparing the Supervisory Action Program:</p> <ul style="list-style-type: none"> • Utilization of a supervisory cycle of no more than three (3) years • use of a combination of comprehensive, random, and thematic inspections as appropriate • allocation of resources in proportion to the risk profile, complexity, and systemic importance of banks • determination of the intensity of inspections depending on the risk profile, complexity, and systemic importance of the bank. <p>The decision to include a bank in the list of inspection is taken based on the proposals advanced by ARDFM departments (NBK can also submit proposals), as well as considering, among other things, qualitative factors, including those related to economic and financial conditions both domestically and internationally, which may have consequences for the bank. The timing of each examination is decided by the ARDFM, based on the internal priorities, as well as the availability of necessary staff and qualified personnel. The list of banks subject to inspection may be revised in the event of significant market and external changes, including those changes in a particular bank that were not detected at the time of initial preparation of the annual inspection plan.</p> <p>The Supervisory Action Program is updated at least once a year, considering the size, nature, scope, and complexity of the activities to be carried out. The Supervisory Action Program is approved by the order of the supervising manager and sent to the Supervision Committee (CP2, EC4) for information by the end of February of the planning year.</p>

	<p>The Supervisory Action Program determines the frequency and intensity of on-site and off-site supervision:</p> <ol style="list-style-type: none"> 1) High supervisory intensity implies the implementation of one or more supervisory actions: <ul style="list-style-type: none"> • <u>daily (weekly)</u> monitoring of the bank's assets and liabilities. • <u>regular</u> participation of the representative at meetings of the bank's collegial bodies. • regular meetings with the bank's management. • thorough analysis of the bank's activity in the interbank market, FX transactions, transactions with derivative financial instruments. • monitoring of payments through the bank's correspondent account with the NBK or through the SWIFT system (if available). • interaction and exchange of supervisory information with regulatory authorities of the countries where the bank's subsidiaries are located. • appointment of additional representatives of the ARDFM to the bank. 2) Medium supervisory intensity implies the implementation of one or more of the following supervisory actions: <ul style="list-style-type: none"> • <u>monthly</u> monitoring of the bank's assets and liabilities. • participation, as necessary, of the ARDFM representative at meetings of the bank's collegial bodies. • meetings with the bank's management. 3) Low supervisory intensity implies the implementation of one or more of the following supervisory actions: <ul style="list-style-type: none"> • monthly monitoring of the state of the bank's assets and liabilities • carrying out the above supervisory actions as and when required. <p>Coordination and information-sharing between on-site and off-site supervision</p> <p>The Agency's supervision process involves interaction between off-site supervision and inspection teams on an ongoing basis, throughout the supervisory cycle, on the following issues:</p> <ul style="list-style-type: none"> • prior to the on-site inspection, the off-site unit communicates to the on-site unit the main risks, deficiencies and issues to be addressed during the inspection. If necessary, the curator may be included in the inspection team. • based on the results of the bank inspection, the on-site division submits the signed report to the curator to register all violations, deficiencies and risks as identified during the inspection. • when conducting a comprehensive inspection of a bank, the on-site division performs SREP assessment, the results of which are also submitted to the off-site division in a separate report for its consideration.
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	<ul style="list-style-type: none"> • the on-site divisions agree with the bank on a plan of measures based on the results of the inspection and submit it to the curator of the off-site division to monitor the implementation of the report by the bank. • when drawing up the Program of supervisory actions for the next year, the off-site division receives information from the on-site division on the results of bank inspections on the volume of provisions on assets and contingent liabilities, identified violations, and the intensity of risks. <p>However, the assessors pointed out that on/off-site interaction needs to be further developed, particularly with regard to the execution of the regular AQR for corporate exposures.</p> <p><u>On-site Inspections</u></p> <p>Law n. 474 II (Art 15-2) envisages two types of on-site inspections:</p> <ul style="list-style-type: none"> (i) risk-based inspection, launched based on the level of risk of the bank not more than once a year. The list of banks subject to risk-based inspection (the inspection plan) is drawn up on a semi-annual basis and it is approved by the head of the Agency. (ii) surprise inspections, carried out in cases provided by the law (for example, reports on breach of law; supervisory processes revealing violations of legal requirements or risks which may potentially undermine the stability of the financial organization, or the interests of its clients; threat to the national and economic security and stability of the financial system; follow-up on the remediation of breaches of law identified during the previous inspection; classification of “bank with unstable financial position” with a threat to the interests of its depositors and creditors or stability of the financial system; bank classified as “insolvent”). <p>Both risk-based and surprised inspections can be general (comprehensive) or thematic (targeted) and conducted independently or jointly with other state bodies or organizations. They cannot last longer than thirty business days, but the duration may be extended only once for a period of no more than thirty working days.</p> <p>Below is the share of banks that were subject to inspections:</p> <ul style="list-style-type: none"> • in 2022—29 percent (a total of 6 inspections: 5 scheduled, 1 unscheduled). • in 2021—50 percent (a total of 11 inspections: 10 scheduled, 1 unscheduled). • in 2020—38 percent (a total of 10 inspections: 1 scheduled, 9 unscheduled). <p>ARDFM conducted only joint inspection with the NBK in 2022 (on accounting automation).</p> <p>Law n. 474 envisages also documentary check (a desk inspection) which does not involve an on-site visit to the banks, but rather a request of documents and data in case the ARDFM identifies signs of violation of the requirements of the law during the analysis of administrative data or following the receipt of reports from individuals, legal entities, and state bodies. Documentary check aims to review compliance with legislation on the issues falling within the remit of the ARDFM.</p> <p>The assessor examined several on-site inspections reports. The inspection function is robust, and findings are incisive, even though they need to be prioritized (for example, by means of an internal scoring) to give the bank a clear recommendation</p>
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	on what need to be corrected in the short-term (urgent) and what could be done in the medium-long term. Also, a more risk-focused approach is needed in areas, such as compliance with AML/CFT rules.
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable ²⁸ and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	<p>In addition to regulatory reporting, ARDFM monitors changes in financial and other indicators from various sources such as—responses to requests from the Agency representatives, monitoring of bank's collegiate bodies, official websites, etc. As part of the annual SREP, the Agency analyzes the bank's internal documents.</p> <p>One important supervisory technique to obtain information as necessary is through its representative in the bank.</p> <p>ARDFM Representative</p> <p>Pursuant to L. 474-II art. 15-9 The representative is appointed among the Agency's employees. The main task is to ensure the implementation of the control and supervisory functions. He/She:</p> <ul style="list-style-type: none"> • analyzes the financial condition of the banks. • controls compliance with regulatory legal acts, requests, instructions, and requirements. • makes proposals for conducting an audit. • participates as an observer at meetings of the board, board of directors, permanent or temporary commissions (committees, working groups). • participates at the general meeting of shareholders (participants) as an observer without the right to vote and express an opinion on the agenda. <p>The representative has the right to: (1) request information and documents in oral and written form, including financial statements and materials of meetings; (2) have access to automated systems and databases without the possibility to make corrections (in view mode). The representative is obliged to inform ARDFM about the non-submission or untimely submission by the bank of the requested information and documents, facts of obstruction, bribery, threats, or other unlawful influence. Banks are obliged to assist the representative in the performance of his/her functions and to ensure the full and timely provision of information. The representative is obliged to professional secret. He/she can be employed in the organization in which he was the representative after one year from the termination of the work. The representative is not responsible for the results and decisions taken during the meetings of the bodies of the organization in which he/she is or was a representative.</p>

²⁸ Please refer to Principle 10.

	<p>The Agency has currently appointed a representative for each of the eight banks supervised by the Division in charge of D-SIB. For medium-smaller banks, one member of staff is representative in more than one bank.</p> <p>The Agency receives the calendar of the board of directors and board committee meeting with the agenda concerned. Depending on the topic, the representative can decide to attend the meeting, communicating the intention to the bank twenty-four hours in advance. During the meeting, the representative might ask clarifying questions, but without driving the discussion. The representative can access the Board/Committee document package, but he/she needs to physically visit the bank. Such a restriction was a limitation during the pandemic and the Agency is considering engaging with the industry to enable the representative to remotely access the bank IT system.</p>
EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> a) analysis of financial statements and account. b) business model analysis. c) horizontal peer reviews. d) review of the outcome of stress tests undertaken by the bank. e) analysis of corporate governance, including risk management and internal control systems. <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p>The Agency uses various tools to assess the safety and soundness of banks of banks.</p> <p>(a) The financial reporting and accounts are regularly analyzed and the internal desk-based AQR is conducted to confirm the level of formed provisions.</p> <p>(b) Business model analysis has been recently introduced.</p> <p>Business Model Analysis</p> <p>NBK Resolution n. 188/2019 (<i>Rules for formation of risk management and internal control system for second-tier banks</i>) requires banks to conduct regular analysis of the business model to assess the impact of strategic risks and the risks inherent to the banks' activities. Then business model analysis assesses the viability and the sustainability of banks' business models based, respectively, on the annual budget and the strategic plan. In the process of strategic and budget planning, the bank shall analyze the key sources of profitability to identify potential risks. To keep the strategy and budget up to date, the bank shall annually analyze the target markets where it operates, evaluate the competitive environment, the adequacy of resources and the ability to generate short- and long-term returns. Strategic and budget planning shall be carried out within the framework of accepted and approved levels of risk appetite.</p> <p>Resolution n. 188/2019 defines a business model as a combination of the chosen strategy, products, and planning processes that ensures competitiveness and a sufficient level of profitability. Leveraging on the SSM framework, the Agency's methodology distinguishes:</p>

- viability, e.g., the bank's ability to provide a sufficient level of profitability in the next 12 (twelve) months, based on budget planning, from the
- sustainability, the bank's ability to provide a sufficient level of profitability for a period of at least 3 (three) years, based on strategic planning.

Sustainability

The strategy must be approved by the board of directors for a period of at least 3 (three) years and contain: the mission and goals of development (goals should be measurable, achievable, realistic, and have precise timelines for implementation); the target market (economic sectors and geographical distribution); a SWOT analysis, considering the key sources of income; quantitative indicators of loan portfolio, liquid assets, customer deposits and other borrowed funds, considering the risk appetite and using realistic assumptions; analysis of key sources of income; key types of investments, including the development of new products and services, and the risks and processes associated with their implementation; scenarios of the strategic development.

Viability

The budget must be approved annually by the board of directors and contain a monthly forecast of financial indicators. It should be consistent with the strategy. The assumptions must be realistic and consider available and accessible resources, current and potential economic conditions, and possible risks. Attention must be paid to the tariff policy, which should include: internal procedures for conducting market analysis of demand and prices of banking services, and for the formation of the structure of interest rates and tariffs; lower and upper limits for interest rates and commissions and internal procedure for their approval; pricing criteria considering also the risks of the activity, and the procedure to inform customers about the economic conditions and their changes. Banks should (i) monthly analyze the budget to ensure that the indicators are consistent with the actual values; (ii) focus on the reasons for the deviations detected, followed by the development of corrective measures, if necessary, and (iii) make reasonable adjustments.

The assessors went through two SREP and found that the Agency conduct business model analysis. ARDFM assesses viability and sustainability of banks business model by looking at a wide range of quantitative indicators (e.g., ROA and cost-to-income) as well as qualitative information (budget, financial projections). The analysis of banks' ability to generate stable and sustainable return contributes to the RBA and forward-looking analysis.

(c) Horizontal peer review

ARDFM conducted a peer review on **consumer lending** to assess the real number citizens with bad debts (see CP8, EC5). No other thematic reviews have been conducted.

(d) Review of the outcome of stress tests undertaken by the bank

Such activity will be carried out in the context of the ICAAP review. Meanwhile the Agency conducts its own supervisory stress test (see EC5)

(e) Analysis of corporate governance, including risk management and internal control systems.

	<p>This assessment is conducted as part of the SREP qualitative analysis and NBK Resolution n. 188/2019 (<i>Rules for formation of risk management and internal control system for second-tier banks</i>) strengthened the concerned regulatory framework (see CP 14, CP 15 and CP 26). However, as detailed in CP14, the assessment needs to be strengthened by means of targeted on-site inspections on corporate governance, to achieve a better understanding of the state of implementation by the banking system of Res.188/2019.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC5	<p>Supervisory stress testing has been gaining increasing importance within the Agency supervisory' s arsenal. Stress testing is conducted on the Agency's own IT system.</p> <p>Stress Testing</p> <p>In 2020, ARDFM and NBK for the first time conducted a stress testing and a comprehensive analysis of the stability of banks to assess the impact of the crisis associated with the spread of the coronavirus pandemic. This work identified risks in the internal processes of banks and confirmed the need to implement supervisory stress testing on an ongoing basis. Between October 2021 to March 2022, ARDFM conducted a stress testing in a pilot mode with the participation of a limited number of banks (n. 4), to test the process and update the target model.</p> <p>Stress testing involves five stages:</p> <ol style="list-style-type: none"> 1) <u>Preparation</u>. On an annual basis, a list of participating banks is determined, based on a quantitative criterion, with the goal to include at least 80 percent of the banking system's assets. Stress testing <u>is performed on a non-consolidated basis</u>, even with the ability to consider the risks associated with banks' subsidiaries specialized in the acquisition of distressed assets. Scenarios are developed and approved jointly by the ARDFM and NBK. The base scenario is a consensus forecast designed by using several baseline scenarios compiled by various experts as input. The stress scenario simulates adverse conditions and includes both macroeconomic shocks and idiosyncratic shocks. Geopolitical situation and macroeconomic changes were considered (GDP – 0.3 percent; oil price dropped to US\$40 per barrel; inflation rate 20 percent; USD/KZT rate 549,3 tenge). In this pilot phase, credit, market, currency risks and changes in net interest and net non-interest income are subject to the stress test exercise. It is planned to expand the scenario operational risk. The time-horizon is three years. In this phase data is collected. 2) <u>Conducting</u>. The internal desk-based AQR is the starting point for conducting supervisory stress-testing: banks' balance sheets are adjusted considering the AQR results and are subsequently used as a starting value for stress testing. Banks are provided with the AQR results, methodology, templates and instructions for completing them, as well as scenarios. If needed, the Agency conducts training sessions. Banks evaluate the impact of scenarios

	<p>on their financial conditions and fill in templates with the results of this assessment. ARDFM uses a “static” balance sheet assumption, freezing assets and liabilities during the entire time-horizon; however, selective adjustments are applied based on the actions of the bank that significantly affect the structure of their balance sheet. The list of allowable adjustments is included in the methodological guidance.</p> <p>3) <u>Verification</u>. The Agency checks the initial data, quality, and adequacy of the banks’ calculations by <u>multiple comparison</u>. It tests the general logic of calculation for each type of risk and compares stress testing results between banks’ portfolios and assets. Comparison is also made with the results of the Agency’s verification model. Based on this assessment, banks receive a status that can be “green” (compliance of the results and calculation logic with the methodology); “yellow” (partial discrepancy, with banks providing confirmation of the correctness of their calculation or adjust them); “red” (a “significant inconsistency” with banks to adjust the calculation and resend it to the Agency). Banks are given a limited number of iterations to resubmit calculations, which is announced annually.</p> <p>4) <u>Decision</u>. The result is intended to be used as input to supervisory decision within the SREP to determine supervisory capital markup (Pillar 2).</p> <p>5) <u>Publication</u> The plan is to publish methodology and templates; Meanwhile the Agency has already published the list of participating banks and the results, both at aggregate level (capital adequacy at the system level, number of banks that successfully passed stress testing) and at the level of individual banks (capital adequacy in the base and stress scenarios, key findings).</p> <p>Indeed, one of the major improvements of the last stress testing exercise was to enhance the transparency of the process. The Agency, together with private consultants, developed a Concept that reveals the main principles and approaches of supervisory stress testing. It shared with banks the methodological guidance; it held training sessions (July-Sep 2021) disclosing the procedures. The pilot stress testing confirmed the effectiveness of the tools and identified areas for improvement for the target model.</p> <p>The Agency is committed to (i) expand scenario to operational risk (ii) use stress test for Pillar 2 purpose (supervisory capital mark-up), and (iii) expand the scope to consolidated supervision, after transitioning to it.</p> <p>The Agency has not conducted stress testing on emerging risk (for example climate related financial risk), but it ran a climate risk sensitivity analysis.</p>
EC6	The supervisor evaluates the work of the bank’s internal audit function, and determines whether, and to what extent, it may rely on the internal auditors’ work to identify areas of potential risk.
Description and findings re EC6	<p>Resolution 188 on the rules for forming a risk management and internal control system establishes requirements for the functioning of the internal audit (see CP 26). ARDFM assesses the bank’s internal audit function as part of SREP. Banks provide internal audit plans, the results of the audit conducted, and the management’s review of the audit results. The work of the internal audit service is also assessed during the conduct of inspection checks.</p> <p>In the context of the SREP, internal audit is assessed by considering:</p>

	<ul style="list-style-type: none"> • how many significant audit findings have been made and how many are still outstanding or overdue. • whether the Audit Plan is updated annually, whether the plan is comprehensive and covers all areas of the bank’s inherent risks at least once every three years. • Whether the internal audit unit has the appropriate skills and knowledge to fully understand and perform its tasks, and whether they are effectively managing the results obtained. • whether the internal audit function recognizes the cases of: (a) proper identification of violations of risk limits and appropriate notification of the bank’s management board, and (b) appropriate notification of the board of directors and the bank’s management board of the implementation of the risk appetite strategy or an equivalent document. • whether the risk management system is subject to regular internal audit reviews (see CP 15 EC5). <p>The Authority shared two examples of bank internal audit assessments as part of inspections. The following weaknesses were identified:</p> <ol style="list-style-type: none"> a) lack of assessment of the efficiency of internal audit by the Board of Directors. b) late consideration and approval of audit reports by the Board of Directors. c) insufficient human resources of the Internal Audit and the lack of an auditor certified in the field of IT. d) the Internal Audit has not checked the procedures, efficiency and correctness of calculation of provisions for the impairment of loans for more than 5 years. e) the Internal Audit has not identified non-compliance with the requirements of current legislation on risk.
EC7	<p>The supervisor maintains sufficiently frequent contacts as appropriate with the bank’s Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank’s Board and senior management on the assumptions made in setting strategies and business models.</p>
Description and findings re EC7	<p>One of the main tools to maintain frequent contact with banks is by appointing a representative (see EC3). The Agency also practices conducting interviews with bank management and employees on various issues. It brings the results of the SREP to the attention of the bank for obtaining comments and explanations.</p> <p>However, the ARDFM should increase contact with non-executive members, particularly the Audit and the Risk Committees, as they would provide an objective view of areas where the interests of management, the company and its shareholders may diverge. Meetings with independent board member of the Audit and Risk Committee should be calendarized in the supervisory plan</p>
EC8	<p>The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank’s management. The supervisor meets with the bank’s senior management and the Board to discuss the results of supervisory</p>

	examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	In the case of identifying risks and shortcomings during the supervision activities, as well as within the framework of the annual SREP, the results are brought to the bank. The Agency provided examples of how the results of on-site inspections are communicated to banks. During the inspection, the preliminary results are communicated to the bank for approval by sending interim acts. The letters are addressed to the managing directors of the banks and, pursuant to Law n. 474-II 1994 art. 15-5, requires the banks to provide comment on the interim report within two working days. Such a term seems too strict to enable defensive rights. The final result of the inspection is communicated to the management within thirty working days from the date of completion of the inspection. The bank can submit objections within 10 working days. Although the Agency representative can decide to (and do) attend the board of directors and board committee meetings, the ARDFM does not regularly meet separately with non-independent board members.
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	ARDFM offered several examples of follow up actions. Following the 2019 AQR, n. 14 banks submitted an action aimed at eliminating specific violations/deficiencies, as well as general corrective measures to improve business processes (planning, budgeting, risk appetite, etc.). The Agency agreed on individual corrective action with a deadline of execution until the end of 2023 (CP 11). In 2021, AQR banks continued to work on the practical implementation of these action plans and ARDFM followed up through remote supervision (review of reports of seven banks) and inspections of six banks. Supervisory concerns addressed processes related to accounting standards (forced restructurings transactions), loans classification and provisioning (impairment triggers), collateral evaluation (verification of reports made by independent appraisal companies, approaches to the valuation of real estate property), reserve level of collective provisioning, methodologies for calculating PD, LGD, EAD, estimation of credit conversion factor, assessing the fair value of securities, formation of prudential reporting, internal audit on the implementation of corrective measures. All corrective measures based on the results of the 2019 AQR are planned to be completed in 2023 in accordance with the originally approved schedule.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	In case of breach of capital requirements, banks should submit a recapitalization plan (banking law art. 42 par. 4). Violation of liquidity requirements were temporarily tolerated as part of the emergency measures adopted in the aftermath of rise of geopolitical tensions, including the Russia's invasion of Ukraine, but banks should submit an action plan to address the violation within nine months. In addition, banks are requested to notify in advance any changes of the types listed below.

	<p><u>Early response measures</u></p> <p>In accordance with the Rules 317 of the NBK (art. 5), in case of independent identification of factors affecting the deterioration of the financial position of the bank (bank group), the bank and (or) its shareholders, bank holding and (or) its large participants within 5 (five) working days from the date of their identification submit to the supervisor an action plan. Factors affecting the deterioration of the financial situation of the bank include:</p> <ol style="list-style-type: none"> 1) decrease in liquidity ratios. 2) an increase in loans with overdue debts on the principal debt and (or) accrued interest in excess of 90 (ninety) calendar days, excluding the formed reserves for them. 3) an increase in the ratio of net classified loans to equity. 4) an increase in loans with overdue debts on the principal debt and (or) accrued interest from 61 (sixty-one) to 90 (ninety) calendar days, excluding the formed reserves for them. 5) exceeding the ratio of loans with overdue debt on the principal debt and (or) accrued interest in excess of 90 (ninety) calendar days, excluding the formed reserves on them, to the total loan portfolio of the bank, excluding the formed reserves on it. 6) an increase in the share of classified receivables without taking into account the formed reserves for it in the total receivables without taking into account the formed reserves for it. 7) decrease in the return on assets ratio. 8) decrease in the average value of the ratio of free assets in national currency to demand liabilities in national currency. <p>For banking group these factors include:</p> <ol style="list-style-type: none"> 1) decrease in the equity capital adequacy ratios of the banking conglomerate. 2) an increase in the coefficients of the maximum amount of risk per borrower of a banking conglomerate. 3) an increase in the amount of claims of participants of the banking conglomerate to each other under intra-group transactions between participants of the banking conglomerate (with the exception of investments of participants of the banking conglomerate in the capital of other participants, transactions with a subsidiary acquiring doubtful and hopeless assets of the parent bank, transactions closed at the reporting date). <p><u>Change in the composition of shareholders</u></p> <p>In accordance with the Banking Law, banks are obliged to notify the authorized body about changes in the composition of shareholders owning ten percent or more of the voting rights and (or) shares placed (minus preferred and redeemed by the bank) within fifteen calendar days from the verification of this fact.</p> <p><u>Notification of approval of financial products by a bank, an organization engaged in certain types of banking operations</u></p> <p>Banks shall notify the authorized body of the approval of financial products by the bank body, within ten working days from the date of their approval.</p>
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	<p><u>Notification of violation of prudential standards for reasons beyond the control of the bank</u></p> <p>In accordance with the Resolution 170 of the NBK, if the bank exceeds the limits of the open foreign exchange position for reasons beyond the control of the bank in terms of changing the currency of the loan issued by the bank by the decision of the court, the bank immediately informs the supervisor and undertakes measure to eliminate the excess within 3 (three) months from the date of detection of this excess. If this excess is not eliminated within the specified period, exceeding the limits of the open currency position in currencies is considered as a violation of this standard from the date of detection of this excess.</p> <p><u>Operational risk events</u> Banks submit to the ARDFM a report on monitoring of operational risk events resulting in losses (Res. 188)</p> <p>Moreover, banks are obliged to provide information on information technology and information security incidents (NBK Resolution No. 48, March 27, 2018) and to notify the ARDFM all information security incidents resulting in damages (Agency Board Resolution No. 90 dated September 21, 2020)</p> <p><u>Materials and information within the framework of remote supervision</u></p> <p>In accordance with the Law n. 474-II1994, the authorized body has the right to receive information and documents, materials of meetings (including those held in absentia), including materials regarding upcoming meetings of remote supervision entities within the established time limits.</p> <p>While the list of ‘substantive change’ events is broad, it does not include all possible material events for example like reputational issues and court actions that have material adverse affects.</p>
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	As stated under CP2, EC 6, although the law does not prevent ARDFM from possibility to use external experts, this occurred only during the 2019 AQR. There is no evidence that the use of third parties results in outsourcing of responsibility for prudential supervision.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	The ARDFM is a user of NBK IT information system. As explained under CP10, the ARDFM has sufficient power to collect, review, and analyze information and reports from banks and groups. However, considering the ARDFM’s dependence on NBK IT systems for accessing bank data, it may be useful to take stock of existing systems and data and consider ways to strengthen, modernize, or build new platforms to support a more effective supervision of the banking sector.
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third-party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.

Description and findings re AC1	
Assessment of Principle 9	Largely Compliant
Comments	<p>ARDFM deploys several techniques and tools to implement its supervisory approach:</p> <ul style="list-style-type: none"> • The designed representative is the focal point for the off-site supervisory processes. He/she is single point of contact between the ARDFM and the supervised banks, facilitates coordination and enables ongoing supervision. • The business model analysis, which is part of the SREP, and the Stress Testing contribute to the forward-looking RBA. However, scenarios for stress testing should expand to new risks (for example, operational risk and exploring also climate-related financial risks) and using results to contribute to determination of Pillar 2 capital. • The regular AQR, which ARDFM is transforming from a traditional on-site technique in a regular off-site tool, should be correctly interpreted as a support for the Agency to focus, in its offsite and (even more) onsite activity, on the banks and portfolios that appear to be more exposed to risks, based on the internal desk-based AQR; said differently it must be clear that the internal desk-based AQR is instrumental to the other activities: i.e., a mean to an end, not an end in itself; it can be particularly useful in the case of granular (e.g., retail) portfolios, in which the small amount of the individual loans would require a disproportionately labor-intensive on-site inspection process and would risk limiting the credit file review to a negligible percentage of the lending portfolio. Nevertheless, its reliability as a remote off-site tool could be limited for assessing individually significant loans which require extensive review of documentation and discussion with banks. Therefore, for the most important corporate exposures, the desk based AQR should be complemented by ad hoc visits to the bank's office and /or stronger coordination with on-site supervision. • The inspection function is effective (for example, it detected unreported related parties transactions in banks defaulted between 2020 and 2021), and findings are incisive, even though they need to be prioritized (for example, by means of an internal scoring) to give the bank clear recommendations on what need to be corrected in the short-term (urgent) and what could be done in the medium-long term. • A more risk-focused approach is needed in certain areas (such as compliance with AML/CFT rules). • Moreover, there seems to be scope for greater use of horizontal on-site thematic reviews (for example, on corporate governance, cybersecurity, digital financial services, related party transactions, underwriting standards) and more frequent contacts with the non-executive members of bank boards. • The list of events that banks must notify should include court actions and reputational issues. <p>Recommendations</p> <p>ARDFM should consider:</p>

	<ul style="list-style-type: none"> • Clarify the role of the internal desk-based AQR as a tool meant to support a more targeted risk-based offsite and (even more) offsite supervision. • Regularly assessing the quality, the effectiveness and integration of its on-site and off-site functions. There seems to be scope for reaping synergies between regular AQR and results of on-site inspections on corporate exposures. • prioritizing the importance of on-site inspections findings and recommendations to banks. • a greater use of horizontal thematic reviews (for example, on corporate governance, cybersecurity, digital financial services, underwriting standards, related party transactions). • more frequent contacts with non-executive bank board members. • include court actions and reputational issues in the list of events to be notified to ARDFM.
Principle 10	Supervisory reporting. The supervisor collects, reviews and analyzes prudential reports and statistical returns ²⁹ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power ³⁰ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	<p>Under B.L. Art. 54, NBK sets reporting requirements for banks “in agreement with” the Agency.</p> <p>The reporting forms are provided in accordance with the requirements of regulatory legal acts, where explanations for filling out the reporting form are also provided. The reporting forms include on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, significant positions, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss reserves, related-party transactions, interest rate risk and market risk.</p> <p>According to the Banking Supervision Guidelines, the supervisor has the right to request explanations (clarifications) regarding reporting and other information about its activities. For example, when reviewing the audit report, financial reporting adjustments, reasons for making the adjustments, and their impact on the financial condition of the bank, banking holding, and non-banking organization are studied. In case of insufficient information for analysis of the reasons for the adjustments, the supervisory authority requests the necessary information from the bank, banking holding, and non-banking organization.</p> <p>Agency staff expressed their concern on dependence on NBK IT systems for collecting more granular data from market participants as well as development</p>

²⁹ In the context of this Principle, “prudential reports and statistical returns” are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

³⁰ Please refer to Principle 2.

	<p>analytical tools for supervisory purposes. The NBK staff expressed disagreement about what legal authority the ARDFM would need to mandate such more granular data, e.g., on corporate lending.</p> <p>It may be useful for the Agency and the NBK to discuss the adoption of a “SupTech” strategy to take stock of existing systems and data and consider ways to strengthen, modernize, or build platforms to enable better usage and access to this data.</p>
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	<p>According to the information received during the mission, the Banking Supervision Guidelines specify data from the financial reporting that must be provided by banks on a periodic basis through automated information systems. This data is used to calculate quantitative indicators. In particular, indicators are generated based on the reporting provided through legacy platforms maintained at the NBK.</p> <p>These reports are submitted in accordance with the requirements of the regulatory legal acts of the Republic of Kazakhstan and in compliance with International Financial Reporting Standards (IFRS). According to the Banking Law, Art. 54, par. 1, and the Law on Accounting and Financial Standards, Art. 2, paragraph 4, banks maintain accounting records and prepare financial statements in accordance with international standards and regulatory legal acts of the National Bank of the Republic of Kazakhstan on accounting and financial reporting.</p> <p>Moreover, the Banking Supervision Guidelines specify data from the financial reporting that must be provided by banks on a periodic basis through automated information systems. This data is used to calculate quantitative indicators. In particular, indicators are generated specifically through the reporting provided via legacy platforms maintained at the NBK called the AIPS “Statistics” and AIPS “ECSP.”</p> <p>It is necessary to enhance the AIPS and ECSP platforms, as the systems are aging and in need of modernization. This topic could become part of the review proposed above in EC. 1 regarding both the NBK’s and the Agency’s visions for a new SupTech strategy.</p>
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	<p>According to points 98-107 of NBK Resolution No. 188, banks are required to maintain an internal control system that is “consistent with the current market situation, strategy, volume of assets, and the level of complexity of bank operations. Internal control is a process that is embedded in daily activities carried out by authorized bodies of the bank, structural units, and all employees of the bank in the performance of their duties...” The control system is required to ensure the effectiveness of the bank and of its risk management; to ensure the “completeness, reliability and timeliness of financial, regulatory and other reporting;” to ensure</p>

	<p>compliance with “civil, tax, banking legislation of the Republic of Kazakhstan...”; and “preventing the bank and its employees from engaging in illegal activities...”</p> <p>The bank is required to maintain procedures for assessing the fair market value of financial instruments that is based on market information (NBK Resolution 188, paragraph 45-11). The resolution gives no further guidance on how fair value must be validated and verified, nor does it describe the role of supervisors in evaluating the reliability and prudence of the fair market value estimates; the resolution should be revised to offer this guidance.</p> <p>The Agency evaluates the quality of reporting by reviewing reports that banks submit, identifying outliers in terms of submissions and seeking explanations from relevant banks for any anomalies.</p>
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	<p>Under Law 474-II Art. 15-8.2 the risk-oriented approach to the supervision of the activities of banks, banking groups, and non-banking organizations takes into account the principle of proportionality, which assumes:</p> <ul style="list-style-type: none"> • consideration of the “size, significance, character, scale and complexity of their activities.” • “categorization according to their importance in the financial market.” • “determination of [the] frequency, depth and intensity of control and supervision.” <p>Law 474-II Art. 14 authorizes the Agency to collect information necessary to conduct its supervision of the financial market and financial organizations.</p> <p>Agency staff indicate that supervisory measures must reflect specific goals that banks must achieve, specifying deadlines and steps that must be taken. They must be proportional to the size of the bank and the outcomes obtained through the annual supervisory assessment under the SREP methodology.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	<p>Periodic reporting is provided on a daily, monthly, or quarterly basis, with deadlines specified by relevant regulatory acts.</p> <p>In accordance with the Bank Supervision Guidelines, the supervisory division performs checks on similar companies that depend on the composition of the relevant peer group. Minor changes in the peer groups over time should not result in different outcomes (accuracy check). The supervisory division should gather current information on the peer group for each business direction (for example, on similar business directions of competing banks).</p>
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	In every bank and if necessary in the banking holding-resident of the Republic of Kazakhstan, a representative of the authorized body is appointed for the term specified in the order of the supervising manager. The representative is called the

	<p>“curator” and is authorized to request from the bank and (or) bank holding company (if necessary) that s/he supervises, and (or) its (their) officials, in oral and written form, information and documents, including financial reporting and materials from meetings (including those held remotely) of the bodies for the purpose of performing the functions assigned to him.</p> <p>Law 474-II also provides for the Agency's powers to request necessary information from any party.</p> <p>Assessors met with supervisors from different departments and teams within the Agency and heard numerous examples of the kinds of information and reports that curators and the Agency are able to gather. Assessors had the opportunity to review several reports requested from banks that provided data and insight into various topics and issues that the supervisors had sought.</p>
EC7	<p>The supervisor has the power to access³¹ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank’s Board, management and staff, when required.</p>
Description and findings re EC7	<p>Law. 474-II Art. 14 authorizes the Agency to collect information necessary to conduct its supervision of the financial market and financial organizations.</p> <p>Law 474-II Art. 15-9 sets out the task, functions, rights, and obligations of the representative that the Agency sends to a bank to help conduct its supervision. The representative of the Agency is also known as the curator (see CP9, EC3). Both curators and supervisors may request any information necessary from supervised institutions.</p> <p>Agency staff elaborated that at the meetings of the Management Board, Board of Directors, permanent or temporary commissions (committees, working groups) of the bank, at the general meeting of shareholders of the bank (hereinafter—the Meeting), a representative is present as an observer without the right to vote; the representative will avoid expressing an opinion on the agenda items of the meetings, though the representative may ask questions.</p>
EC8	<p>The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank’s senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.</p>
Description and findings re EC8	<p>According to the Banking Supervision Guidelines, supervisory measures must reflect specific goals to be achieved by banks, specifying deadlines and steps that must be taken. They must be proportional to the size of the bank and the outcomes obtained during the annual SREP assessment methodology.</p> <p>Under B.L. Art. 45-1.2, the grounds for applying supervisory response measures include violations of law, the detection of illegal actions or inaction of bank managers that may threaten the bank’s stable functioning and/or the interests of their depositors, creditors, clients and correspondents, the failure to present or the presentation of unreliable reporting or information, as well as other requested information.</p> <p>In addition, under Article 168-2, paragraph 1 of the Code on Administrative Offences of the Republic of Kazakhstan, the Agency may impose fines on individuals, officers,</p>

³¹ Please refer to Principle 1, Essential Criterion 5.

	or legal entities (bank, bank's major shareholder, bank holding company), for failing to submit reports or for submitting false statements or information. Where necessary, the ARDFM may require banks to submitted corrected reports.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ³²
Description and findings re EC9	<p>According to the Agency staff, information obtained from the supervisory assessment of the risk assessment system, bank reporting (regulatory reports, external and internal reporting), results of previous inspections, and other information that allows for the assessment of the quality of information used for control and supervision by the authorized body are used for inspection purposes.</p> <p>In practice, banks submit required reports to the single "window" at the NBK. The NBK then ensures the accuracy of the data by performing logical and mathematical checks of the data. The Agency then gains access to the data as a user and is responsible for ensuring that the data is reliable. Where the information is inaccurate, the Agency requires the bank to develop an action plan to correct the data. In the case of inaccurate data, the curator assigned to the relevant bank decides whether to recommend to the Agency that the submission represents a breach of any particular regulation or law.</p> <p>Based on monthly changes in the main financial indicators of banks, information received from the bank's representative, data from monitoring individual loans, information obtained during consolidated supervision and other supervisory information, the curator prepares a monthly management report on the results of bank supervision, which includes the main risks, financial indicators dynamics, current capital and liquidity reserve of the bank, and, if necessary, proposals for supervisory measures regarding the bank. This management report is provided to the leadership of the supervisory division.</p>
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, ³³ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	According to information received during the mission, current legislation does not prohibit the Agency's ability to employ external experts. One example of using the services of external experts could be the AQR of the banking sector assets in 2019 as well as the hiring of an external consultant to assist in developing the Agency's stress test. Legal consultants may also be involved in supervisory matters. When recruiting external experts, a technical task is formed, the scope of work, supervisory tasks, and

³² Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

³³ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	processes that may result in conflicts of interest are defined. However, as stated under CP2, budget limitations affects the Agency ability to hire external experts.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	When engaging external experts, regular discussions are held on the results of the work being carried out and the current status, in order to identify risks and shortcomings and take appropriate measures in a timely manner.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The agency has a process of periodic information checks to determine if it meets the supervisory needs. If deficiencies are identified, the requested information may be corrected.
Assessment of Principle 10	Largely Compliant
Comments	<p>Supervisory authorities have sufficient power to collect, review, and analyze information and reports from banks and groups. The Agency’s representative assigned to monitor a bank throughout the year—the “curator”—in particular plays a special role in requesting and analyzing information and reporting from banks separately from onsite inspections as well as participating in meetings of the management of the bank or its board. All banks are assigned a curator; one curator is appointed for each domestic systemically important banks, while for smaller banks, one curator may be assigned to cover multiple banks.</p> <p>The Agency should strengthen its guidance to banks on how they should validate and verify their estimates of the fair value of assets as well as describe the role of supervisors in evaluating the reliability and prudence of the fair market value estimates.</p> <p>Considering the dependence on NBK IT systems for accessing bank data, it may be useful to take stock of existing systems and data and consider ways to strengthen, modernize, or build new platforms to support a more effective supervision of the banking sector. This could form part of a new “SupTech” strategy for the two authorities to improve the effectiveness of supervision and make better use of existing data.</p>
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank’s management or, where appropriate, the bank’s Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank’s Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.

Description and findings re EC1	<p>As noted in the Banking Law (Art. 45-3), the agency sends letter to Board of Directors or Management Board or shareholders when it identifies deficiencies that must be corrected. Art. 45, para. 3. Agency staff generally will ask the bank for a prioritization of the deficiencies, including an action plan and a timeline for correcting the issues. Under the law, the response must be sent within five days (Art. 45, para. 3).</p> <p>If the remediation required is small, the curator appointed to oversee the bank's supervision may review the response. If it is more complicated, the Agency may send a team of onsite inspectors to review the actions, which may include reviewing documentation of the bank's responses.</p> <p>If the matter is considered serious, Agency staff will raise the remediation with the supervision committee, and the deputy head of the agency will validate the appropriateness of the response.</p> <p>Assessors evaluated examples of inspection reports sent to the Board of Directors following onsite inspections, including one report from a joint inspection led by the agency and the NBK. The reports were clear in stating the focus of the inspection and the nature of the concerns agency staff had identified, providing ample evidence of the matters requiring attention. Most of the reports that assessors reviewed outlined action points and deadlines for the banks concerned, though one report was vague in sections about the supervisors' expectations. The Agency should consider prioritizing its findings so that the Board of Directors and management of the bank understand which deficiencies are of the greatest concern and require the most or immediate attention, versus other matters that can be corrected over time.</p> <p>In case of detection of deficiencies and risks in the bank's activities, the Agency applies relevant supervisory measures with respect to the bank, specifically, requiring the provision of a detailed plan of measures to eliminate the identified violations and risks. The plan of measures includes measures to eliminate, the execution deadline and responsible officials. The Agency controls the bank's implementation of the approved plan of measures to eliminate the identified violations and risks, based on the bank's monthly (quarterly) report.</p>
EC2	<p>The supervisor has available³⁴ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.</p>
Description and findings re EC2	<p>When the Agency identifies deficiencies in a bank, B.L. Art. 45-1 sets out the supervisory response measures.</p> <p>In the event of deficiencies and risks being identified in the bank's activities, the Agency applies the appropriate supervisory measures with respect to the bank. The measures include requiring the bank to strengthen its financial condition or undertaking steps to minimize risks, which are described in Art. 46-1.</p> <p>In more severe circumstances, the Agency may also prescribe sanctions if other supervisory responses would be insufficient to protect depositors, strengthen the financial stability of the bank or bank group (B.L. Art. 47-1 and 47-2). These "coercive supervisory measures" include requiring major participants or bank holding companies to reduce their holdings of voting shares of the Bank; requiring the bank</p>

³⁴ Please refer to Principle 1.

	<p>to reduce its holdings of a subsidiary; requiring the bank to suspend activities between the subsidiaries; requiring the bank to reduce its ownership of a subsidiary; requiring entities incorporated into the banking group to suspend activities; or requiring the bank to raise capital.</p> <p>The plan of measures includes measures to address deficiencies, the deadline for implementation, and the responsible officers.</p> <p>The Agency oversees the implementation by the bank of the approved plan of measures to eliminate the identified violations and risks, based on the bank's monthly (quarterly) report.</p> <p>The agency does not have an "enforcement unit" to ensure that the bank responds appropriately to supervisory findings and instead relies mostly on the curators for validation. If a bank fails to address the deficiencies in the agreed time period, the Agency may escalate its response, including applying sanctions in the most serious cases; these sanctions are confidential.</p>
EC3	<p>The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.</p>
Description and findings re EC3	<p>Early intervention measures can be taken before a bank violates minimum requirements for capital, liquidity, and non-performing assets, under B.L. Art. 45-1 and 45-2.</p> <p>It should be noted that the Agency relaxed certain capital and liquidity standards in response to the COVID-19 pandemic and the conflict in Ukraine. Following the outbreak of the pandemic and the lockdowns that followed to protect public health, some borrowers had lost their jobs and could not repay in full outstanding loans. The Agency gave those borrowers three extra months to repay.</p> <p>With regard to Ukraine, some banks in Kazakhstan experienced an outflow of deposits following the outbreak of war; banks were given nine months to restore their liquidity requirement.</p> <p>The risk-oriented approach applied by the Agency since 2019 does not require it to wait for a formal violation of established norms and to respond in the early stages of deterioration of the bank's financial position or increased risks. B.L. Art. 46, par. 1, enables the Agency to work to improve the financial condition of a bank or reduce its risks by requiring the bank to holding liquidity and capital in excess of the minimum requirement; to suspend or restrict activities; to restructure assets or liabilities; to reduce costs; and so on.</p> <p>The Agency applies the relevant supervisory measures with respect to the bank, namely, it requires the provision of a detailed plan of remedial actions to eliminate the identified violations and risks.</p> <p>The remedial action plan outlines the measures for elimination, the timeframe for completion, and the responsible personnel.</p> <p>The Agency oversees the bank's implementation of the approved remedial action plan to eliminate the identified violations and risks, based on the bank's monthly (quarterly) report.</p>

EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>As noted under EC 2, the Agency has a number of supervisory response measures it may employ, ranging from directing firms to strengthen their financial condition or reduce risks in the ordinary course of business to more significant measures in response to more severe weaknesses or breaches. As noted earlier, in the assessment of EC 3, the Agency can respond before a firm breaches minimum prudential requirements.</p> <p>If a bank falls below the minimum threshold for solvency, the Agency can recommend resolution measures.</p> <p>The ARDFM can remove individuals from their positions (BL 46-1.12) as a supervisory response, which includes executives named in BL 20, such as the head of the executive body, the deputies of the head of the executive body, and the head of a branch, The ARDFM may also remove members of the board of directors (BL 11) as a supervisory response.</p> <p>Curators may request information at any time on any matter. Onsite supervisors have the ability to visit a bank onsite and conduct reviews at any time.</p> <p>The Agency does not have the ability to prevent stock buybacks.</p> <p>For example, the agency has the right to apply the following supervisory measures to the bank:</p> <ol style="list-style-type: none"> 1) the use of supervisory response measures (B.L. Art. 45-1). 2) the imposition of sanctions (Art. 47). 3) imposition of administrative fines for administrative violations. 4) classification of the bank as a bank with an unstable financial position that poses a threat to the interests of its depositors and creditors and (or) a threat to the stability of the financial system (Art. 61-1). 5) classification of the bank as an insolvent bank (Art. 61-7). 6) assessment (analysis) of the financial and property condition of the bank, including by visiting the bank and involving appraisers, auditors, and other organizations. 7) introduction of a conservatorship regime for the bank (Art. 67-1). 8) dismissal of the head of the executive body if the person fails to comply with supervisory measures. (Art. 45-1.7).

	<p>The measures of supervisory response as a tool for early intervention encompasses a wide range of possible restrictions and actions that are established by law (Art. 46.1). For example, measures to improve the financial state of a bank (banking group) include the possibility of imposing demands for the following (all from Art. 46.1):</p> <ol style="list-style-type: none"> 1) maintaining capital adequacy ratios and/or liquidity ratios above minimum values set by the authorized body. 2) suspension or restriction of certain types of banking and other operations, the execution of certain types of transactions, or the establishment of a special order for their implementation. 3) restructuring of a bank's assets and/or obligations, including changes to their structure. 4) reducing expenses, including by terminating or limiting additional hiring of employees, closing certain branches and offices, subsidiary organizations, limiting monetary rewards and other types of material incentives for top employees. 5) suspension or restriction of investments in certain types of assets, and others. 6) formation of provisions (reserves) according to international financial reporting standards. 7) recognition of a physical or legal entity as a person related to a bank, banking holding, an organization performing certain types of banking operations, special relationships. 8) change of the conditions of a transaction concluded on favorable terms with a person related to a bank, banking holding, an organization performing certain types of banking operations, special relationships to conditions of similar transactions with third parties, concluded on the date of the transaction with favorable terms. 9) restriction of operations with persons related to a bank, banking holding, an organization performing certain types of banking operations, special relationships. 10) cessation of accrual and (or) payment of dividends on ordinary and (or) preferred shares and (or) perpetual financial instruments. 11) review of internal policies and procedures, limits on the permissible size of risks, procedures for evaluating the effectiveness of the risk management system and internal control. 12) suspension of executives, specified in Article 20 of the Banking Law and normative legal act of the authorized body that establishes the procedure of risk management and internal control system formation, including in case the bank, bank holding company, organization conducting certain types of banking operations, and non-resident bank of the Republic of Kazakhstan are removed from their official duties until the authorized body applies this supervisory response measure. If this supervisory response measure is applied to the executive officer, the authorized body shall revoke the consent for appointment (election) to the position of executive officer. 13) evaluation of the value of property owned by the major participant of the bank and (or) bank holding company.
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	<p>14) elimination of causes and (or) conditions which contributed to violation of rights and legal interests of depositors and (or) creditors and (or) clients of banks, organizations involved in certain types of banking transactions.</p> <p>15) ensuring compliance of their activities with the legislation.</p> <p>Assessors discussed examples with Agency staff of the Agency's use of various supervisory response measures. In addition, Assessors review reports of inspection and other documents that evidenced the identification of deficiencies and the use of supervisory response measures to require banks to address these deficiencies.</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	<p>In addition to the ability to remove the head of the executive body for failing to comply with supervisory response measures, the Agency has other options for applying sanctions to individual members of management or the board.</p> <p>The Supervisory Department leads interviews of individuals who will join the Board of Directors of a bank or assume another senior leadership role within the bank as part of the "fit and proper" evaluation of key executives.</p> <p>As part of the control and supervision of the bank's activities, the Agency has the right to use motivated judgment against the bank's executives and candidates for the positions of the bank's executives. This makes it possible to exclude or prevent unscrupulous persons from the bank's activity (see CP8, EC1). Also, in case of revealing risks and shortcomings, the Agency has the right to remove the executives from their positions (for examples of this authority, see B.L. Art. 20.8; or Art. 46.12.)</p> <p>The website of the Agency publishes the names of prospective board members or executives who have been approved for roles with second-tier banks as well as the names of those who have been denied. However, it is important to note that senior heads of control functions such as the chief risk officer or chief compliance officer are not subject to these fit and proper tests (CP5, EC7).</p> <p>Agency staff report that executives involved in insolvencies at a bank can be barred from working within the banking sector for five years. However, the Agency does not make public the list of individuals barred from banking. The agency's authority to bar executives from banks that become insolvent is broad; in exercising its power, it should also consider the culpability of the executive in any insolvency rather than ban all executives in such circumstances.</p> <p>Assessors discussed examples of the Agency applying such sanctions with Agency staff and reviewed documents evidencing the use of such sanctions.</p>
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	<p>In the Agency's efforts to conduct consolidated supervision, it seeks to identify risks in the activities of the banking group (including within individual members of the banking group), trends potentially affecting the deterioration of the financial condition of the banking group, and associated risks.</p> <p>The agency conducts its analysis of intragroup transactions of the banking group participants on the basis of quarterly reporting of such transactions. Supervisors evaluate the sufficiency of assets and funds provided by major participants of the</p>

	<p>bank (including individuals) as additional capital resources of the bank. Moreover, the Agency seeks to evaluate the business development strategy of the banking group and its projected budget for the next fiscal year. Should the Agency find risks and negative trends affecting the financial condition of the banking group or noncompliance with legal requirements on the part of one of the banking group members, the Agency is empowered to apply supervisory response measures to the banking group member.</p> <p>At the same time, as noted above in response to question EC4, the B.L. allows applying measures to the bank (a member of the banking group) in the form of (1) suspension and (or) restrictions on certain types of banking and other operations, the performance of certain types of transactions or establishing a special procedure for their implementation, (2) suspension and (or) restrictions on investments in certain types of assets or establishing a special procedure for their implementation.</p> <p>With regard to ring-fencing the bank from the actions of parent companies, subsidiaries, and other related parties, Art. 46.1.8 enables the Agency to change the “terms of a transaction made on preferential terms with a person related with the bank, a bank holding company, an organization carrying out certain types of banking operations by special relations, on the terms of similar transactions with third parties...” Likewise, Art. 46.1.9 allows the Agency to restrict “transactions with the persons related with a bank, a bank holding company, an organization carrying out certain types of banking operations by special relations...”</p> <p>However, B.L. Art. 45 par. 7 exempts non-resident bank holding companies rated no lower than “A” from early intervention measures if an agreement for information exchange is in place between ARDFM and the home supervisor. This might restrain the supervisor from initiating early response measures.</p> <p>The agency relies on quarterly reports of intragroup transactions to monitor the condition of the banking group and the terms of those transactions. Assessors reviewed examples of such reports, which provided basic insight into such transactions.</p>
EC7	<p>The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).</p>
Description and findings re EC7	<p>The ARDFM is the main body entrusted with the mandate to resolve troubled banks and houses the resolution authority. The ARDFM is operationally independent and makes decisions on its own about resolving insolvent financial institutions. Others involved in the decision-making process, including with respect to questions about the resolution of systemically important banks, can include the Kazakhstan Deposit Insurance Fund, the government, or the Presidential Administration. NBK can be included into the decision-making process on resolution of a systemically important bank only in its capacity as FSC member.</p> <p>Currently there are no legal requirements for recovery plans (plans to restore financial stability) and there are no recovery or resolution plans drafted by the ARDFM on any of the systemic banks.</p> <p>Instead, at the time of the assessment, Resolution #188 of the Board of the National Bank of the Republic of Kazakhstan, dated November 12, 2019, contains</p>

	<p>requirements on development and approval of: (1) a funding plan in case of unforeseen circumstances in terms of liquidity; and (2) a contingency plan.</p> <p>By end-2023 the ARDFM plans to (1) adopt amendments to legislative acts by implementing comprehensive regulatory requirements for banks' recovery plans, and (2) develop internal supervisory methodology to assess banks recovery plans.</p> <p>According to B.L. Art. 68.1 a bank may be resolved ("liquidated" in the translation of the law) (a) at the decision of its shareholders, with the concurrence of the Agency or (b) under a decision of a court.</p> <p>For a court to consider a forced resolution of the bank, the Agency must submit its conclusion that the bank is insolvent. Only a court may declare that the bank is bankrupt and must be resolved (Art. 71). A court may also consider the resolution of bank if its license has been revoked on grounds provided in banking legislation or if "authorized state bodies, legal entities and individuals" apply to the court to terminate the bank's activities on the basis of other laws. (Art. 72 and Art. 70)</p> <p>The resolution process could include a compulsory reorganization of the bank (Art. 74–3), a merger with another institution (Art. 74-3.4), or a forced liquidation (Art. 74–4). Current laws do not allow for the use of deposit insurance for resolution.</p> <p>The NBK is involved in the decision-making process to resolve systemically important banks through its membership in Financial Stability Council (FSC). Under its legal statute, the FSC preliminarily considers and provides recommendations on the following issues:</p> <ol style="list-style-type: none"> 1) macroprudential policy implementation to mitigate systemic risk in the financial system. 2) anti-crisis measures. 3) the resolution of an insolvent bank, a forced liquidation that leads to systemic risks to the financial system, including government participation in its resolution. 4) financing second-tier banks' rehabilitation, including financing from NBK and (or) its subsidiaries. Similar to the assessment of CP2, the involvement of the executive branch in decisions regarding the resolution of a bank could lead to questions about supervisory authorities' independence. This matter has been assessed already under CP 2. The resolution process is also assessed in greater detail within a separate workstream of this Financial Sector Assessment. <p>During the mission, assessors discussed with the ARDFM examples of decisions to close banks, such as the closing and sale of branches of Russian banks in the aftermath of the Ukraine conflict. Assessors found these experiences to be largely aligned with this core principle.</p>
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.

Description and findings re AC2	
Assessment of principle 11	Largely Compliant
Comments	<p>The ARDFM as a range of supervisory response measures as well as sanctions at its disposal, and assessors discussed examples of their use with Agency staff and reviewed documents evidencing their use. However, it is important to note that the Agency exercised forbearance in loosening capital and liquidity requirements in response to the COVID-19 pandemic as well as the outbreak of war in Ukraine. In particular, certain violations (of the liquidity coverage ratio (LCR), net stable funding ratio (NSFR), other liquidity ratios due to outflow of deposits, revaluation of assets and liabilities) have been temporarily tolerated (from February 21, 2022, to December 31, 2022), subject to banks providing an action plan to address such violations within 9 months. While these are meant to be temporary, the persistence of stressed conditions at global level suggests that the requirements should be restored to their typical levels expediently to reduce the potential for risks to expand during this prolonged period of uncertainty.</p> <p>The ARDFM's authority includes responsibility for resolution, and the presence of the resolution authority within the ARDFM simplifies the coordination necessary to resolve banks. That said, at the time of the assessment, requirements had not yet been created for supervised banks to develop resolution and recovery plans. The authorities should implement this requirement.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ³⁵
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	Banks identified as groups are subject to consolidated supervision in Kazakhstan. The Banking Supervision Department evaluates corporate structures and determines which firms meet the requirements to be considered and supervised as a banking group on a consolidated basis. As of year-end 2022, the Agency counted 12 banking groups under its supervision, a reduction by one compared to year-end 2021 following a merger of two banks. Of these twelve, two are considered to have a simple structure, meaning less than seven subsidiaries; seven are of medium complexity (seven to nine subsidiaries); and three are considered complex (nine or more subsidiaries). Only two banking groups have any overseas operations at all. One has just one office abroad and 6 subsidiaries at home, while the other as offices in 4 other countries, but 14 based in Kazakhstan.

³⁵ Please refer to footnote 9 under Principle 1.

	<p>Banks considered to be parts of banking groups are subject to consolidated supervision in Kazakhstan. B.L. Art. 1, subpar 3 Law sets the following definition of a banking group: a group of legal entities consisting of a bank holding company (if any) and a bank, as well as subsidiaries of the bank holding company and (or) subsidiaries of the bank, and (or) organizations in which the bank holding company and (or) its subsidiaries, and (or) the bank have a significant participation in the capital. While some banking groups have nonbanks, the nonbanks represent a small share of total assets, and this analysis focuses on the prudential supervision of the banking subsidiaries.</p> <p>According to B.L. Art. 41 the Agency regulates the activities of banks both in relation to an individual bank and on a consolidated basis, i.e., in relation to a bank group.</p> <p>B.L. Art. 40-5 establishes the requirement for a banking group to have a risk management and internal control system on a consolidated basis. The list, forms and terms of reporting by banking groups were established.</p> <p>The Agency also uses the reporting data to analyze the banking group's activities on a quarterly basis and determine the factors affecting the deterioration of the banking group's financial position.</p> <p>While the Agency has the enabling legislation to set supervisory expectations for groups, such as creating standards for risk management systems in a group, staff acknowledged in discussions that the Agency's requirements for groups are not as well developed as risk management requirements for individual banks. Staff have identified supervisory guidelines for groups and consolidated supervision as an area for further development.</p> <p>According to B.L. Art. 44, the Agency carries out inspections of the activities of members of banking groups independently or with the involvement of other government agencies and (or) organizations. At the same time, the Agency has the right to inspect the activities of affiliated persons of banks solely for the purpose of determining the extent and nature of their influence on the activities of banks. Participants of the banking groups, as well as their affiliated persons, are obliged to assist the Agency on the issues of verification, as well as to provide an opportunity to interview any officials and employees and access to any sources of information necessary for the verification.</p> <p>In order to obtain information on the risks affecting the members of the banking group due to significant intragroup transactions conducted between the members of the banking group, which are financial institutions, the Agency interacts with other regulators on questions concerning transactions on the acquisition and (or) sale of shares of financial institutions, including planned sales, if necessary.</p>
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
Description and findings re EC2	According to B.L. Art. 41, in order to ensure the financial stability of banks, to protect the interests of their depositors, and to maintain the stability of the monetary system, the Agency regulates the activities of banks, including by setting prudential standards and other standards and limits mandatory for banks, provisioning against doubtful and bad assets. The regulation of banks' activity is carried out both in respect to an individual bank and on a consolidated basis, i.e., in respect to the banking group.

	<p>In that regard, according to B.L. Art. 42, the Agency has the right to set for bank groups that lack a bank holding company certain prudential norms and their regulatory values at a level sufficient to cover potential significant losses arising from possible maximum changes in risk factors.</p> <p>With regard to those prudential standards, the Agency may set and apply standards both to individual banks and to banking groups. Resolution No. 309 of the Board of the NBK dated December 26, 2016, contains the list of minimum prudential requirements for banking groups, namely the minimum amount of the authorized capital, the equity capital adequacy ratio, and the maximum size of exposure per borrower (NBK Resolution 309, para. 2).</p> <p>In particular, Agency staff report that the maximum size of risk per borrower is established for other borrowers (not more than 25 percent of the total capital of the banking group) and separately for related persons (not more than 10 percent of the total capital of the banking group).</p> <p>In practice, however, the Agency has not yet developed capital adequacy standards for banking groups that align with international standards, nor does it apply liquidity standards to the whole group. For liquidity, prudential standards apply only the individual bank level; no laws or regulations currently apply liquidity requirements at the group level.</p> <p>Similarly, while capital can be calculated at the consolidated level, at the moment the Agency applies a basic measure to nonbanks in the group. While the Basel capital framework excludes insurance companies from consolidated capital requirements, for example, the Agency’s capital requirements for groups simply sums up capital across financial institutions in a group regardless of the kind of financial service provider. Agency staff are working to strengthen these and other aspects of consolidated supervision.</p> <p>The Agency also regularly receives the following reports from banking groups:</p> <ul style="list-style-type: none"> • information on investments. • data on the intragroup transactions of the banking group. • information on major liabilities of the banking group members to third parties. • report on the structure of the securities portfolio of the banking group members. <p>Assessors reviewed several reports of inspection, including two reports outlining findings from SREP reviews. In both cases, assessors found that the reports of inspection were detailed, relied on evidence, and identified issues requiring correction without prescribing a particular solution.</p>
<p>EC3</p>	<p>The supervisor reviews whether the oversight of a bank’s foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks’ policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>

Description and findings re EC3	<p>As few firms have overseas operations, the Agency appears to be less experienced in conducting the analyses described in this Essential Criterion to evaluate a bank's ability to access information from foreign operations. Moreover, the Agency has not yet evaluated the effectiveness of supervision in foreign jurisdictions.</p> <p>B.L. Art. 40–5 requires a banking group to have a risk management and internal control system on a consolidated basis. The parent organization is responsible for the compliance of members of the banking group with the requirements to the risk management and internal control system.</p> <p>In the performance of control and supervision functions, the Agency checks for deficiencies and (or) risks in the activities of organizations, which are part of the banking group, including in terms of control of the parent organization, heads of organizations over cross-border operations of the organization, which is a part of the banking group.</p> <p>Within the framework of risk assessment system in the study of corporate governance issues, the section "Analysis of corporate governance" analyzes internal policies of the bank, limiting transactions with related persons (shareholders, members of the Board of Directors, the Management Board, their relatives and other persons). The section "Analysis of capital" describes internal processes for monitoring transactions with persons related to the bank by special relations and preparation of appropriate management reporting.</p>
EC4	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
Description and findings re EC4	<p>Agency have made no trips abroad to conduct assessments of foreign offices given their sense that activity was insignificant.</p> <p>The Agency indicated that it does exchange information with host supervisors on the basis of agreements with those authorities. See Core Principle 13 for more insight.</p>
EC5	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>Under BL Article 44, the ARDFM is sufficiently empowered to verify and evaluate the activities of bank holding companies as well as other members of the banking group. The ARDFM has authority to inspect those entities' activities to determine their implications for banking activities.</p> <p>However, as explained, the ARDFM currently doesn't perform fully consolidated supervision.</p>
EC6	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <p>(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;</p>

	<p>(b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or</p> <p>(c) the exercise of effective supervision on a consolidated basis is hindered.</p>
Description and findings re EC6	<p>The Agency has the authority to undertake a number of measures under B.L. Art 46 “to eliminate deficiencies, risks or violations, including those identified with the use of motivated judgment,” that could limit the range of activities of the banking group and help to improve the financial standing of the bank (banking group). The circumstances in which the Agency could apply these measures are described in NBK Resolution 272, among other sources.</p> <p>“Under this article, the Agency can impose the following requirements:</p> <ol style="list-style-type: none"> 1) maintenance of equity capital adequacy ratios and (or) liquidity ratios above the minimum values established by the authorized body. 2) suspension and (or) restriction of carrying out certain types of banking and other operations, commission of certain types of transactions or establishment of a special procedure for their implementation. 3) restructuring of assets and (or) liabilities of the bank, including changes in their structure. 4) reducing costs, including through the termination or limitation of additional hiring of employees, closure of certain branches and representative offices, subsidiaries, limitations on monetary rewards and other types of material incentives for the executives. 5) suspension and (or) limitation of investments in certain types of assets or establishment of a special procedure for their implementation. 6) formation of provisions (reserves) according to international financial reporting standards. 7) recognition of an individual or a legal entity as a person related with a bank, a bank holding company, an organization carrying out certain types of banking operations by special relations. 8) changing the terms of a transaction made on preferential terms with a person related with the bank, a bank holding company, an organization carrying out certain types of banking operations by special relations, on the terms of similar transactions with third parties on the date of transaction with preferential terms. 9) restriction of transactions with the persons related with a bank, a bank holding company, an organization carrying out certain types of banking operations by special relations. 10) termination of accrual and (or) payment of dividends on ordinary and (or) preferred shares and (or) perpetual financial instruments. 11) revision of internal policies and procedures, limits on the allowable amount of risks, procedures for assessing the effectiveness of the risk management and internal control system. 12) suspension from performing duties of the persons specified in Article 20 of this Law, including in case of suspension by a bank, a bank holding company, organization carrying out certain types of banking operations, of the persons,

	<p>specified in Article 20 of this Law, from performing duties until applying this supervisory response measure by the authorized body.</p> <p>When applying this supervisory response measure to the executive employee, the authorized body shall withdraw the consent for appointment (election) to the position of an executive employee.</p> <p>13) conducting assessment of property value owned by a major participant of the bank and (or) a bank holding company.</p> <p>14) elimination of the causes and (or) conditions that contributed to violation of the rights and legitimate interests of depositors and (or) creditors and (or) customers of banks, organizations carrying out certain types of banking operations.</p> <p>15) ensuring compliance of their activities with the legislation of the Republic of Kazakhstan.”</p>
EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group. ³⁶
Description and findings re EC7	<p>According to Article 41 of the Law on Banks, the Agency regulates the activity of banks, both with respect to an individual bank and on a consolidated basis, i.e., with respect to a banking group.</p> <p>For more details, please refer to point EC1 Principle 12.</p>
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	
Assessment of Principle 12	Materially non-compliant
Comments	<p>Risk management and key prudential requirements apply only on a solo level and not yet on a consolidated level. This deficiency severely weakens the Agency’s approach to consolidated supervision.</p> <p>The Agency has self-identified consolidated supervision as an area in which it intends to align its prudential regulation of financial groups with the requirements of the Basel Committee on Banking Supervision. Likewise, it intends to set supervisory and risk management expectations at the consolidated level in accordance with international standards set by the Basel Committee. The assessment seeks to recognize that supervisors have begun to implement consolidated supervision yet have considerable work ahead to comply fully with the Basel Core Principles.</p> <p>In particular, the Agency is encouraged to consider the application of prudential standards such as liquidity and capital at the level of both the individual bank and on a consolidated level. With regard to supervisory expectations, we encourage the Agency to build out its requirements for risk management on a consolidated level.</p>

³⁶ Please refer to Principle 16, Additional Criterion 2.

	For groups with international operations, the Agency should require those groups to assess regularly whether any impediments exist to receiving information from foreign operations so that they can manage those operations appropriately. Similarly, the Agency should evaluate the effectiveness of supervision in jurisdictions in which its banks have operations and determine when onsite visits to such operations are warranted.
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	<p>Given the insignificant shares of foreign subsidiaries in the total assets of Kazakhstani banks, the Agency so far has not seen a need to create any cross-border banking supervisory colleges. Agency staff estimate that fewer than 5 percent of assets owned by Kazakhstani banks are booked in overseas branches or subsidiaries. However, the Agency is now considering whether to establish a small number of colleges for those Kazakhstani banks that are active in multiple jurisdictions.</p> <p>The Agency is a member of the International Organization of Securities Commissions (IOSCO) and has signed IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU). The MMOU facilitates the sharing of information between securities regulators. Likewise, it is a member of the International Association of Insurance Supervisors (IAIS) and is planning to sign the equivalent Multilateral Memorandum of Understanding to facilitate information-sharing with insurance supervisors.</p> <p>In order to obtain information on the risks affecting the banking group members due to significant intragroup transactions conducted between the banking group members being financial institutions, transactions on acquisition and (or) sale of shares of financial institutions, including planned ones, the authorized body shall interact with other regulators supervising the insurance sector and securities market participants, as well as the division on protection of financial services consumers, as necessary. The interaction shall be based on written inquiries, meetings and other types of information exchange.</p> <p>The information exchange is carried out on the basis of the concluded agreement between the Agency and the host financial supervisory authorities of local supervised entity of the bank or bank holding company.</p>
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices

	of the banking group ³⁷ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	<p>While the Agency has a number of MOUs in place with foreign regulators, staff acknowledge that they have limited contact with those regulators and have not participated in a supervisory college in recent years. Some of the MOUs carry over from the prior incarnation of the supervisory authority and have not yet been updated. Consequently, the Agency has undertaken little collaborative work with foreign supervisors since its founding.</p> <p>Assessors reviewed examples of the MOUs, which covered the basic expectations for supervisory cooperation. One MOU has not yet been concluded for a G-SIB that has a limited presence in Kazakhstan. The ARDFM was unable to enter into an MOU with the relevant home supervisor, as the home supervisor did not respond to the ARDFM's request. As noted elsewhere, the ARDFM is encouraged to try again, as it is in the home supervisors' interest to be aware of any significant concerns the ARDFM may have; it is equally important for the ARDFM to have direct contact with the relevant home supervisor in case significant concerns emerge.</p>
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	As noted above, staff have acknowledged in discussions with assessors that they have limited contact with foreign regulators. As noted above in EC2, the Agency has undertaken little collaborative work with foreign supervisors since its founding.
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	Agency staff are reassessing their engagement with foreign regulators and are considering ways to strengthen their ties and communications, including potentially by establishing a new supervisory college for a Kazakhstan bank with more significant international activities.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	As noted, the ARDFM has undertaken efforts to sign MOUs with regional supervisors, but has not been active in dialogue with foreign supervisors.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution

³⁷ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	As noted earlier, Kazakhstan authorities have formed the Financial Stability Council since the spin-off of supervisory functions from the NBK into the ARDFM precisely to improve coordination on financial stability issues, including with regard to resolution matters. Notwithstanding this progress, the crisis management framework has substantial limitations. The MoU on Financial Stability Issues, signed in 2007, is outdated, and NBK plans to develop a new triparty MoU that would involve NBK, the ARDFM, and the Government. Moreover, resolution responsibility is not separated from banking supervision: a resolution authority is currently not operative, and it is formally integrated into ARDFM Supervisory Department. There is no recovery and resolution planning framework: banks do not submit recovery plans and ARDFM Division "Resolution of Problem Bank" does not prepare resolution plans for the systemic banks. Moreover, while the ARDFM has worked to sign MOUs with foreign supervisors, it has not yet been active in dialogue with those supervisors. While the country now has a foundation for this work, considerable effort will be required to bring group resolution planning into full compliance with the Basel Core Principles.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	For cross-border acquisitions, the Banking Law requires the applicant to provide an analysis of the legislation of the host country where the subsidiary is located indicating the "absence of circumstances" that would make it possible for the Agency to conduct consolidated supervision because the members of the banking group in that jurisdiction would not be possible to comply with the requirements of the laws of the Republic of Kazakhstan (Art. 11-4.6).
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	While the ARDFM has signed MOUs with a number of foreign supervisors, it has not undertaken cross-border supervisory work to date. As a result, the assessors have no insight yet in whether foreign supervisors will afford the ARDFM sufficient access to local offices during visits and inspections abroad.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	For cross-border acquisitions, the Banking Law requires the applicant to provide an analysis of the legislation of the host country where the subsidiary is located indicating the "absence of circumstances" that would make it possible for the Agency to conduct consolidated supervision because the members of the banking group in that jurisdiction would not be possible to comply with the requirements of the laws of the Republic of Kazakhstan (Art. 11-4.6). Information on whether host supervisors prohibit shell banks was unavailable at the time of the review.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.

Description and findings re EC10	AS noted above, the ARDFM has not yet worked closely with another foreign supervisor to demonstrate how well it will coordinate with supervisors globally.
Assessment of Principle 13	Materially non-compliant
Comments	Since the Agency's founding, it has not been sufficiently proactive in its approach to home-host relations, such as in not reviving or establishing any supervisory colleges as the home country supervisor. While the activities of internationally active banks are low today, this has not always been (and might not always be) the case, and supervisors should be prepared for changes in such activities. The Agency does have a number of MOUs with foreign supervisors, yet it lacks one MOU for the home country supervisor of a significant global bank active in Kazakhstan.

B. Prudential Regulations and Requirements

Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, ³⁸ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	<p>The corporate governance and risk management framework has been strengthened by NBK Resolution No. 188/2019 establishing "<i>Rules for formation of risk management and internal control system for second-tier banks.</i>" Banks are established in the form of joint stock companies with a clear distinction of responsibility between:</p> <ul style="list-style-type: none"> the board of directors which, among other things, sets up the strategy and defines the number and term of reference of the executive body (Join Stock Company Act; Law 415/2013 Art. 53 - JSC). the executive body, which manages the day-to-day business, implementing the decision of the Board of Director (Art. 59 and 60 JSC). The executive body might be collegial or individual. <p>According to NBK Resolution No. 188/2019 par. 21 the <u>board of directors</u> has the below responsibilities:</p> <ul style="list-style-type: none"> duty of care and duty of loyalty (EC4). active involvement in the activities of the bank and awareness of significant changes, as well as the adoption of timely decisions to protect the long-term interests of the bank. preliminary consideration of the draft code of corporate governance approved by the general meeting of shareholders (JSC Art. 36), including a procedure to

³⁸ Please refer to footnote 18 under Principle 5.

	<p>manage the conflict of interest (EC5) and bank's employees confidentially duties.</p> <ul style="list-style-type: none"> • ensuring compliance of the bank's corporate governance system with the scale, nature, structure, risk profile, and bank's business model; protection of shareholders' rights; timely and reliable disclosure of information. • approval of organizational structure of the bank, development strategies, profitability policies, stress testing procedures and scenarios, contingency financing plan, business continuity management policies, remuneration procedures, and policies on personnel, accounting, tariff, credit underwriting, problem assets, internal control, risks management (credit, market, operational, IT and information security, compliance, AML/CFT, liquidity, collateral), internal audit, external auditors. • approval of ICAAP and ILAAP. • approval of the risk appetite strategy (EC5) and monitoring compliance with it. • ensuring the availability of a financial service responsible for accounting and the quality of financial reporting. • preliminary approval of the annual financial statements certified by an audit organization. • <u>election of members of the executive board of the bank</u>, appoint the head of risk management, the head of the internal audit and the chief compliance controller. • consider the reports sent by the audit committee and monitor the elimination of violations. • control the compliance with bank's procedures, via which employees report violations related to the activities of the bank. • set up the three lines of defense system (CP25). • control Board's activities by monitoring the implementation of the strategy and decisions of the general meeting of shareholders; approving internal documents regulating the activities of the board; ensuring the implementation of the internal control system; holding regular meetings; analyzing and critically assess the information received; establishing performance standards and a remuneration system for board members that meet the long-term goals defined by the strategy and aimed at financial stability. • interact with the head of risk management. • periodically (at least once a year) assess the performance assessment of each board member. • maintain records of decisions and make them available to ARDFM upon request. • provide a developed IT infrastructure to collect and analyzing complete and reliable information for risk management purposes, being aware of the IT limitations in determining appetite risk levels. • taking credit decision exceeding certain thresholds (CP16 EC5). <p>The <u>executive board</u> (NBK Resolution No. 188/2019 par. 33) is responsible for:</p> <ul style="list-style-type: none"> • ensuring the implementation of the strategy, and the compliance with the procedures, processes and policies approved by the board of director. • developing the draft strategy, budget, and profitability management policy for the board approval. • developing the procedure for communicating the strategy, policies and other internal documents within 10 (ten) business days from the date of the approval
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	<ul style="list-style-type: none"> • developing the personnel policy for the board approval, and the procedure for the remuneration of employees. • assessing the performance of bank employee. • developing the tariff policy for the board of directors' approval and monitoring compliance with it. • developing the credit policy, for the submission to the risk management committee and the board of directors' approval. • approving the plan to ensure continuity and restoration of activities. • providing the board of directors with the necessary information to monitor and evaluate the quality of the work of the executive board (achievement of the goals established by the strategy, compliance of activities with the bank's strategies and policies, results of the bank's activities, financial situation, stability/volatility of the bank's profitability, inconsistency of decisions with procedures, processes and policies, breach of risk appetite and the reasons for violation, timeliness, completeness and quality of elimination of violations, and information on the state of internal control). • developing an internal procedure for considering customer requests arising in the process of providing banking services, as well as monitoring the compliance with it. • developing a procedure for refusing to carry out high-risk operations, including operations with values created in decentralized information system using cryptography, as well as termination of business relations with a client taking into account the inherent risk factors. <p>The executive board is responsible for the proper execution of duties delegated to collegial bodies or employees within the approved organizational structure of the bank.</p>
EC2	<p>The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.</p>
Description and findings re EC2	<p>ARDFM assesses bank's corporate governance policies and practices and their implementation in the context of the risk assessment, where the corporate governance is one of the four Pillar of the SREP (along with business model, risk to capital and liquidity).</p> <p>The SREP assessment of the banks' corporate governance leverages on a questionnaire (about 30 questions) which focuses on the regulatory requirements (Res. 188/2019) pertaining, among other things, to the setup of the Committee; the approval of policies, procedures, and risk appetite statement; the existence of the three lines of defense; the reporting lines, including the direct risk management access to the board etc. While this approach can be considered compliance based, it is only a starting point to verify that banks adhere to Res. 188/2019 standards, and it is complemented by further activities. For example, Findings from on-site inspections are discussed with the curators and, if needed, included in the SREP assessment. Moreover, ARDFM representative is a focal point for assessing banks' corporate governance, as he/she attends, as an observer, Board and Committee's meetings, depending on the agenda and can also access the Board/Committee document package. This enables the representative to focus on the analysis of</p>

	<p>decisions based on the results of the meetings of collegial bodies, where key decisions on the bank's activities are made, enhancing the risk-based approach.</p> <p>Even though the assessors were not provided with statistical information on the number of meetings attended by its curators, the ARDFM clarified that the frequency of such attendance is risk-based, depending on the classification of the bank in the Supervisory Action Plan (see CP9, EC5). When a bank is classified as <i>"high"</i> supervisory intensity, the participation of the curator in the banks' collegial bodies occurs <i>"regularly,"</i> for banks classified as <i>"medium"</i> intensity, the curator's participation in its collegial bodies takes place <i>"as necessary,"</i> for those banks considered as <i>"low"</i> intensity, such participation occurs <i>"when required."</i></p> <p>However, the ARDFM has never conducted targeted onsite inspections focused on assessing banks' governance.</p> <p>Resolution n. 188/2019 has brought important changes to the corporate governance framework. Nevertheless, the Agency has not conducted a thematic review on banks' corporate governance to assess banks against the state of implementation of the mentioned Resolution n. 188/2019.</p> <p>Correction of deficiencies in a timely manner</p> <p>The Agency requires banks to correct deficiencies in a timely manner.</p> <p>The frequency and intensity of follows-up with banks to correct any governance-related deficiencies depends on the importance of the deficiencies and can take the form of recommendation or prescriptions. The assessors examined several documents shared by the Agency and found adequate follow-up action either on offsite supervision (SREP) or onsite inspections, even though with some points of improvement. For example, the assessors went through:</p> <ul style="list-style-type: none"> • A recommended supervisory response measure, addressing risk and deficiencies in the corporate governance and risk management emerged during the SREP. However, considering the nature of the violations, (shortcomings in terms of compliance with the legal requirements, untimely submission of individual and consolidated annual financial statements, and failure to achieve NPL targets) the assessors are of the opinion that the Agency's follow up should have taken a binding form, rather than a recommendation. • A written notice contesting, among others, the violation of Res. 188/2019 (the lack of an approved strategy by the Board of Directors) and Res. 170 (miscalculation of the liquidity coverage ratio) along with the request to the bank to correct the deficiencies. • A written notice following up on an onsite inspection report, highlighting several deficiencies (untimely and inaccurate information reported to the credit bureau, incomplete risk appetite, non-compliance with market, operational and liquidity risk management requirements, and inadequate provisioning methodology) and requesting the submission of an action plan by the bank. <p>Usually, the bank's action plan should envisage one year for its implementation; if a request for an extension is supported by a robust motivation, the Agency can extend it; otherwise, it would require its implementation within the original timeline. In general, the deadline for the implementation of corrective action depends on the severity of the deficiency. Corrective action plans included governance elements like</p>
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	<p>business planning, budgeting and strategy development, calibration of risk appetite limits.</p> <p>Pursuant to Resolution No. 188/2019, the main elements of an effective corporate governance system are:</p> <ol style="list-style-type: none"> 1) organizational structure. 2) corporate values. 3) strategy. 4) distribution of duties and powers regarding decision-making between authorized bodies of the bank. 5) mechanisms of interaction and cooperation between members of the board of directors, management board, external and internal auditors. 6) procedures and methods of risk management. 7) internal control system. 8) remuneration system. 9) availability of an adequate management reporting system. 10) transparency of corporate governance. <p>The organizational structure of the bank shall correspond to the chosen business model, the scale of activity, types, and complexity of operations; it should minimize the conflict of interests and distributes risk management powers between collegial bodies and structural units, including, but not limited to, the board of directors and its committees, the management board, the risk management unit, the compliance office, and the internal audit unit.</p>
EC3	<p>The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members</p>
Description and findings re EC3	<p>ARDFM assesses the governance structure and the appropriateness of the processes for nominating and appointing Board members through its representative (see EC 1), in the context of the SREP (see EC 2), and during on-site inspections. The qualitative analysis of the SREP includes corporate governance issues, as well as policies and processes, and their implementation. Also, when it conducts comprehensive inspections, the Agency covers, among other things, issues of the quality of corporate governance in banks.</p> <p>In effect, the SREP methodology covers the assessment of Board members, namely the composition and collective suitability of the board. However, the assessment of banks' corporate governance is best done through onsite inspections; to that aim, there is room for targeted on-site inspections on corporate governance. They could also take the form of a targeted review of the state of implementation of Resolution n. 188/2019.</p> <p>The ARDFM shared several documents supporting evidence of offsite and onsite supervision on corporate governance.</p>

	<p>Members of the board of directors are elected by the general shareholder meeting, which defines the number (no less than three), the terms of office and the amount and conditions of remuneration (JSC Art. 35). The ARDFM representative can also attend general shareholders meetings.</p> <p>The executive board are elected by the board of director (EC2)</p> <p>The board of directors can include a representative of shareholders. The members of the executive body, except for its head, cannot be elected to the board of directors. The head of the executive body cannot not be elected the chairman of the board of directors (JSC Art. 54).</p> <p>At least one third of the board of directors' members must be independent (JSC Art. n. 20 and Art. 54 par. 5).³⁹</p> <p>Pursuant to NBK Resolution n. 188/2019 Chapter 3, par. 22, the composition of the board of directors and its powers shall be sufficient to exercise effective control. The board of directors should consist of members with the necessary qualifications, impeccable business reputation and experience, sufficient for the general management of the bank, in accordance with the chosen business model, scale of activity, type and complexity of operations. Minimum years of experience are prescribed by the Banking Law (art. 20, par. 5; see CP 5). Members of the board of directors shall focus on interaction, cooperation and critical discussion in the decision- making process. They should conscientiously fulfill their duties and minimize conflicts of interest.</p> <p>Board's Committee</p> <p>To increase work efficiency and based on the selected business model, scale of operations, types and complexity of operations, and risk profile, the board of directors creates special committees. Each committee carries out its activities within a defined framework in terms of powers, competence, principles of work, internal procedure for reporting to the board, division of tasks and restrictions on the duration of work. The board of directors provides for periodic rotation of members (except for experts) of such committees to avoid concentration of powers and to promote new views. The committees keep records of the decisions made. The chairman of the board's committee must be a member of the board of directors who is not a head or member of the executive body. Committees of the board of directors consider the following issues: Audit, Risk management, Strategic planning, Staff and remuneration; other issues stipulated by internal documents of the bank.</p> <p>Based on Reg. N. 188/2019 ("<i>the board of the directors creates . . .</i>"), establishing the abovementioned committees is mandatory. However, ARDFM has not conducted an assessment of the implementation of these requirements by banks. As stated under EC1, the ARDFM representative can attend the meetings of these committees, examining their functioning and main areas of improvements; however, to identify and share best practices and detect major deficiencies in the functioning of these</p>
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³⁹ The JSC adopts the follow definition of independent: not an affiliated person and has not been a member of the board of directors for three years prior to his/her election; not subordinated to the officials of the joint stock company and was not subordinated to these persons during the three years prior to his/her election to the board of directors; is not a civil servant; is not a representative of a shareholder and was not a representative of a shareholder during the three years, prior to his/her election; is not involved in the audit of the joint stock company as an auditor, working as part of the audit organization and was not involved in such audit within three years prior to his/her election to the board of directors.

	<p>committee, it would be useful to conduct a thematic review on the state of implementation of Resolution n. 188/2019.</p> <p>Audit Committee</p> <p>The audit committee includes only members of the board of directors of the bank. The chairman must be an independent director, but there are no similar requirements for other members (see BCBS Guidelines Corporate Governance Principles for banks par. 68) The committee shall include at least one board member with experience in the field of audit and (or) accounting and financial reporting and (or) risk management.</p> <p>The audit committee shall be responsible for:</p> <ul style="list-style-type: none"> • internal audit policy, code of ethics for the internal auditor, internal audit unit and procedures, and the management information system. • interaction with the external auditor, monitoring the implementation of the recommendations, reviewing the annual financial statements for further submission for preliminary approval by the board. • policies (procedures) for attracting an external auditor (criteria and conditions for the selection, provision of advisory services on audit matters, payment for the services). • preliminary review of the annual internal audit plan. • preliminary consideration of the results of internal and external audit reports, monitoring the timely implementation to eliminate violations. • consideration of ARDFM inspections and opinions of other experts regarding the structure and effectiveness of the overall risk management system and internal control at the bank. • assessment of internal audit effectiveness. <p>Risk management committee</p> <p>The chairman of the risk management committee shall be an independent director of the bank, or the chairman of the board of directors, but there is no similar requirement for the majority of other members (see BCBS Guidelines Corporate Governance Principles for banks par. 71). The Committee includes at least one member with experience in the field of risk management or internal control. The Risk Management Committee is responsible for the development of:</p> <ul style="list-style-type: none"> • risk appetite strategy, determining the risk profile, and monitoring the observance by the bank board. • document regulating the basic approaches and principles of ICAAP and ILAAP. • stress testing procedures and scenarios. • continuity management policy and monitoring compliance with the policy. • contingency financing plan.
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	<ul style="list-style-type: none"> • policy of IT risk management of and information security and monitoring compliance with it. • compliance risk management policy and for monitoring compliance with it. • internal procedure to determine the functioning of the management information system, to ensure that the board of directors is provided on a regular basis with complete, reliable, and timely information about level of risks taken internal models for risk management. <p>Documents under n. 1, 3, 4, 5, 6, and 7 are submitted to the board of directors for approval.</p> <p>The risk management committee should also consider the results of the assessment of the quality and effectiveness of the risk management and internal control systems, and corporate governance in general. It must regularly receive the data and reports from the risk management unit(s) and other responsible departments on the current risk level of the bank, violations of risk appetite levels and risk mitigation mechanisms.</p> <p>Committee on personnel and remuneration</p> <p>The chairman of the HR and Remuneration Committee shall be an independent member of the board of directors and the Committee shall include at least one member with experience in the field of personnel management. The HR and Remuneration Committee shall be responsible for ensuring the development of:</p> <ul style="list-style-type: none"> • the draft organizational structure of the bank for the approval by the board of directors, taking into account the minimization of the conflict of interests. • procedures for managing a conflict of interests and mechanisms for its implementation for further approval by the relevant authority of the bank. • remuneration policies in accordance with NBK Resolution 2012 No. 74 (EC7). <p>Strategic planning committee</p> <p>The chairman of the Strategic Planning Committee shall be an independent member of the board. At least one member should have experience in the development of information technology or provision of banking services, risk management or budget planning. The Committee is responsible for drafting for further submission for approval by the board of directors:</p> <ul style="list-style-type: none"> • the strategy. • the budget and the control over its implementation. • the profitability management policy and the monitoring compliance with it. <p>The Committee submits for the board of directors' consideration the information on the implementation of the strategy, development plans, achievement of target values of the strategic key indicators of the bank.</p> <p>The SREP examines whether the bank has authorized collegial bodies for risk management and an audit committee and committees at the Board of Directors.</p>
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	<p>Moreover, the assessors could verify the participation of the ARDFM's curator also in meetings of sub-Committee (for example, the Large-exposure Committees). This enabled the Agency to challenge the credit decision-making process, questioning the information provided to the Board of Director on certain high-risk operations (for example, credit limit approved despite the borrower's negative credit history, or loans granted without collateral in spite of the recommendation of the underwriting unit)</p> <p>However, considering the material deficiencies emerged in relation to transactions with related parties (see CP 20), the Agency could also challenge the role of independent directors requiring 'check and balance' mechanisms in the approval process of related party transactions (for example, the independent directors' reasoned, binding or not binding, opinion on the bank's interest in entering into these transactions, as well as on the convenience and substantial correctness of its underlying terms).</p>
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty". ⁴⁰
Description and findings re EC 4	<p>Fit and proper requirements for executive employees are prescribed by BL 2444 art. 20 and have been described under CP5 EC8. These requirements are assessed (i) at the licensing stage and (ii) when the banks appoint new board of director and/or management board members. The assessment is carried out by the curator and the management of the Department of Banking Regulation (Deputy Head of the Department, Head of the Department) during off-site supervision. The candidate profile is sent to the curator for a joint evaluation.</p> <p>Resolution No. 188/2019 par. 21 introduced, among the basic principles and responsibilities of board of directors, the:</p> <ul style="list-style-type: none"> • <u>duty of care</u>—rational decision-making and acting in the interests of the bank based on a comprehensive assessment of the information provided in good faith, with due diligence and care. The obligation to exercise caution and care does not extend to errors in the process of making business decisions, unless members of the board of directors have shown gross negligence. • <u>duty of loyalty</u>—making decisions and acting in good faith in the interests of the bank, not considering personal benefits, interests of executives connected with the bank by special relations, to the detriment of the interests of the bank. <p>ARDFM monitors that these principles are met within the context of the SREP, which analyzes the level of understanding by members of the Management Board of responsibility for the consequences of non-compliance with risk management principles, regardless of whether their actions or behavior resulted in losses. Moreover, 'duty of care' and "duty of loyalty" are also assessed by the inspection team during onsite supervision, when the board of director and the management board are evaluated for the effectiveness of their work. If the Agency detects</p>

⁴⁰ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

	violation of these duties during general (comprehensive) on-site inspections, it adopts consequent supervisory actions: for example, in 2020 there were cases of removal of board directors (including the Chairman), deemed not fulfilling their duties related to the satisfaction of this CP. In addition, the assessors went through four on-site inspections reports dealing with corporate governance issues and found adequate evidence of the Agency's oversight of corporate governance. For example, the assessors could verify that the inspection team reviewed the Board of the Directors and the Management Board minutes related to the audited period and challenged (i) the concentration of function at certain decision-making level (Deputy Chairman of the Credit Committee) with possible signs of conflict of interest, and (ii) the hiring of managers despite the negative opinion of the Bank's Security Department with identified negative information.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite ⁴¹ and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	<p>ARDFM assesses during the SREP that the banks' boards approve and oversee the implementation of the strategy, the risk appetite, communicate corporate culture and value and establishes conflicts of interest policies and a strong control environment. The Agency's assessment of the risk appetite strategy focuses on its consideration of all material risks, the compliance with the risk appetite strategy (RAF), the inclusion of qualitative indicators that define clear reasons for taking or avoiding risks, the timely information to the Head of Risk Management and the Management Board about violations of limits by the heads of business lines.</p> <p>The assessors found compelling evidence of adequate coverage of such aspects of corporate governance in the supervisory activity. For example, an Agency's written notice followed up an onsite inspection report and highlighted several deficiencies among which the incompleteness of the bank's risk appetite. An on-site inspection report challenged the lack of internal limits on the concentration of funding in the bank's risk appetite. However, an intensive and intrusive thematic review of governance and risk appetite would enable ARDFM to systematically assess the adequacy of risk appetite in the context of strategic decision discussions; the board's understanding of the relationship between the risk appetite statement and the business strategy, as well as the board oversight of the corporate culture and value.</p> <p>Risk appetite</p> <p>Resolution n. 188/2019 introduced the requirement for the board of directors to approve the risk appetite strategy. To build an effective risk management system, the Board of directors shall approve the risk appetite strategy defining clear limits to the volume of accepted risks and determining the risk profile of the bank's activities, to mitigate risks or minimize their negative impact on the financial position of the bank. The risk appetite strategy must be considered in the strategic and budget planning; the ICAAP and ILAAP; and the formation of the organizational structure of the bank.</p>

⁴¹ "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	<p>An effective risk appetite strategy should: describe the risk profile of the bank; contain the process of disseminating the strategy to all structural units and be brought to the attention of bank employees; introduce a risk culture at all levels of the bank; protect the bank from taking excessive risks; change in case of significant changes in market conditions and (or) the level of financial stability of the bank.</p> <p>Within the framework of the risk appetite strategy, the board of directors shall form a <u>risk appetite statement</u> that sets a general direction with respect to the risks accepted by the bank in the budget planning and then operational activity. Effective statement of risk appetite shall: (1) be formed taking into account the strategy of the bank; (2) determine for each significant type of risk the aggregated level (levels) of risk appetite, which the bank accepts in its activities taking into account the risk profile; (3) include quantitative indicators and a statement of a qualitative nature that describes the grounds for taking risks by the bank, or their exclusion, and (4) imply a prognostic approach, considering the results of stress testing to identify potential events leading to a violation of risk appetite levels.</p> <p>The level of risk appetite should have a clear definition; be relevant; measurable; and calculated on a periodic basis. It should: (i) be set at a side that facilitates the compliance with the aggregated level(s) of risk; (ii) consider available capital, liquidity, profitability, development strategy, significant concentration of risks (client, currency, country, market segments); (iii) be based on best practices and effective level of inherent risk; (iv) be developed using clear (not ambiguous) assessment; (v) be regularly reviewed, including infra-annual review when the situation of the market change; (vi) consider reasonable assumption including the stress test results.</p> <p>Risk appetite levels shall include different types of limits: (i) those not requiring the application of corrective measures; (ii) those defined as 'permissible' but requiring separate corrective measures; (iii) 'high limits,' requiring the application of appropriate measures to prevent the deterioration of the financial stability of the bank and its solvency.</p> <p><u>Conflict of interest</u></p> <p>There is no limit to multiple memberships for the members of the board of directors. This could give rise to conflict of interests (and in the same case impinge on the time commitment). The Agency might need to consider maintaining evidence of multiple membership.</p> <p>One of the basic principles for the board of directors' responsibility is to provide preliminary considerations of the draft code of corporate governance approved by the general meeting of shareholders, including a procedure to manage the conflict of interest, as well as control over its implementation. This procedure to manage the conflict of interest shall contain: mechanism for minimizing conflicts; the approval process that a member of the board of directors goes under before taking up the functions of an official in another organization in order to prevent a conflict of interest; obligation of members of the board of directors to immediately provide information on any issue that creates a conflict of interest or is a potential reason for its occurrence; obligation of members of the board of directors to abstain from voting on issues within which a member of the board of directors has a conflict of interest; the mechanism for the board of directors to respond to violations of the provisions of the procedure.</p>
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	As regard the control environment, the Board of Director is responsible for setting up the three lines of defense system. This is assessed by the Agency during the SREP cycle and on-site examination.
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	<p>Fit and proper standards for banks' executive employees are set forth by BL 2444 Art. 20 and assessed by ARDFM at the licensing stage and when changes occur in the banks' governance. However, as stated under (CP5, EC8), the definition of executive employee does not include the responsibility for internal control functions.</p> <p>The Board of director is requested to monitor and evaluate the quality of the work of the executives based on information related to: achievement of the goals established by the strategy; compliance of activities with the bank's strategies and policies; results of the bank's activities; financial situation; stability/volatility of the bank's profitability; inconsistency of decisions with procedures, processes and policies; breach of risk appetite and the reasons for violation; timeliness, completeness and quality of elimination of violations; and information on the state of internal control.</p> <p>ARDFM examines how the board oversees senior management performance mainly through its representative and during comprehensive onsite inspections. There seems to be room for more targeted on-site inspections on corporate governance.</p> <p>There are no requirements for succession plans.</p>
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	<p>Resolution n. 188/2019 requires that the board of directors establish a remuneration system for board members that meet the long-term goals defined by the strategy of the bank and aimed at financial stability.</p> <p>When, according to the proportionality principle, the HR and Remuneration Committee is set up, the Committee is responsible for ensuring the development of remuneration policy for the board of Director approval in accordance with NBK Resolution 2012 No. 74. Pursuant to NBK Resolution 2012 No. 74, banks should develop, implement, and maintain an internal policy on remuneration and other types of material incentives for managers consistent with the business plan, goals, strategy, directions and scope of activities, financial prospects, as well as the creation of an appropriate and effective mechanism of corporate governance and risk management. The internal policy contains:</p> <ul style="list-style-type: none"> • goals, objectives, and principles of accrual of remuneration to senior employees. • the structure of fixed and variable remuneration of managers. • levels and rules for increasing the remuneration of executives. • a system for evaluating the performance of managers.

	<ul style="list-style-type: none"> remuneration system for executives who coordinate and (or) control the activities of structural units engaged in the activity of the bank, depending on the achievement of the strategy, business plan and other internal documents in terms of income or performance while maintaining the level of risks and capital within the values determined by the bank. conditions under which the variable is not paid. <p>The amount of remuneration directly depends on the ratio of risk to result. The remuneration system shall provide for the possibility of changing the amount of variable remuneration taking into account all risks, including violation of risk appetite limits, internal procedures or requirements of the authorized body. There are requirements related to deferral (suspension), conversion into share or cancellation (in case of losses) of the variable remuneration. Moreover, the bonus part of the remuneration of the head and employees of the internal audit unit shall be established in such a way as to exclude the occurrence of a conflict of interest and not question the independence and objectivity of the internal audit unit.</p> <p>ARDFM did not structurally assess how bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, but it rather provided one example of on-site inspection where it challenged banks remuneration. The staff pointed out that that such a variable component can be material in D-SIB. For those which benefitted from state support, the Agency could consider restriction on the variable remuneration until the banks reimburse the public support.</p>
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>ARDFM through the SREP qualitative analysis examines elements of the risk management and internal control system, which includes corporate governance issues related to understanding the operational structure of the bank and banking group and its risks. SREP analyzes whether the bank has adequate information systems, IT infrastructures, and procedures to provide appropriate, reliable, timely, and complete information to the board of directors and management and analyzes the extent to which board members and management are aware of information and data collection limitations.</p> <p>Moreover, licensing rules are meant to ensure transparency of ownership structure.</p> <p>In addition, the evidence provided to the assessors showed that the Agency verifies the requirements of this EC also during on-site examinations (for example, in relation to the bank's strategy and risk management requirements). Nevertheless, the use of AMC specialized in purchasing distressed from their parent company does not contribute, in the lack of an adequate consolidate supervision, to the transparency of the baking groups' asset quality. This should be covered by the supervisors in their assessment of the Board's oversight of banking group structures.</p>
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	Pursuant to BL 2444 art 46, ARDFM, to eliminate deficiencies, risks or violations, including those identified with the use of motivated judgment, shall apply measures for improving financial situation and (or) minimizing the risks of banks, an

	<p>organization carrying out banking operation, bank holding company, banking group, organizations included in a banking group, a major participant of the bank (CP 11).</p> <p>Among these measures, the Agency can apply the '<i>suspension from performing duty</i>' to bank's executive employee. When applying it, ARDFM withdraw the consent for appointment (election) to the position of an executive employee (see also CP5, EC7). In case of revocation of the ARDFM consent, the bank is obliged to terminate the employment contract with this person or, in the absence of an employment contract, to take measures to terminate the powers of this executive employee.</p> <p>In 2020 there were cases of removal of board directors, deemed not fulfilling their duties related to the satisfaction of this CP.</p>
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	
Assessment of Principle 14	Largely Compliant
Comments	<p>Resolution n. 188/2019 has enhanced the regulatory framework for corporate governance, addressing some findings of the 2014 BCP, namely:</p> <ul style="list-style-type: none"> the prescription for large and complex banks to establish a Risk Management Committee (EC3; to be noted that this prescription is not envisaged by the JSC). the requirement for the board of director to approve a risk appetite strategy and introduce a risk culture (EC5). <p>There are still some points of improvement in the regulation:</p> <ul style="list-style-type: none"> a requirement for the board to introduce plans for succession are missing. there is no limit to multiple memberships for the members of the board of directors and this could give rise to conflicts of interests (and in some cases impinge on the members' time commitment). <p>ARDFM is striving to ensure compliance with the new governance requirements. To that aim, the representative (curator) ca plays a pivotal role for the assessment of corporate governance arrangements attending banks' collegial bodies "<i>regularly,</i>" "<i>as necessary</i>" or "<i>when required,</i>" depending on the supervisory intensity spelled out in the Supervisory examination plan. The SREP assessment leverages on a questionnaire, but incorporates, when needed, findings from on-site inspections, as well as findings from off-site supervision revealing shortcomings in corporate governance (for example, deficiencies in risk data aggregation and reporting). Onsite supervision remains critical to assess the "<i>duty of care</i>" and "<i>duty of loyalty</i>" of board members, as it entails a review of the collegial bodies' minutes of the audited period, the identification of conflict of interest, and the verification that decision-making process is sound and incorporates the opinions of the technical units (for example, risk management, legal department).</p>

	<p>Moreover, ARDFM did not structurally assess banks and banking groups' compensation policies. Finally, the ARDFM has not conducted a thematic review on state of implementation of the mentioned Resolution n. 188/2019 across the system.</p> <p>Recommendations</p> <p>Resolution n. 188 should consider (i) requirements for the board to introduce plans for succession, and (ii) limits to multiple memberships.</p> <p>Considering that the on-site inspection coverage is limited, albeit not negligible (share of banks 38 percent in 2020; 50 percent in 2021; 29 percent in 2022), the Agency could further enhance off-site supervision of the corporate governance by conducting (i) thematic reviews on the state for implementation of resolution n. 188/2019, including via targeted on-site inspections and (ii) scheduling targeted on-site inspection on corporate governance as part of the supervisory examination plan; (iii) a structured assessment of remuneration policies and practices as well prevent banks which benefitted from state support from paying variable remuneration until the banks reimburses the public support.</p>
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Principle 15	Risk management process. The supervisor determines that banks ⁴² have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate ⁴³ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank. ⁴⁴
Essential criteria	
EC1	<p>The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that:</p> <p>(a) a sound risk management culture is established throughout the bank;</p>

⁴² For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 9 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

⁴³ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

⁴⁴ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	<p>(b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite;</p> <p>(c) uncertainties attached to risk measurement are recognized;</p> <p>(d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and</p> <p>(e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.</p>
Description and findings re EC1	<p>ARDFM emphasized that it verifies that banks have appropriate risk management strategies approved by the Boards and that the Boards set a suitable risk appetite mainly during the SREP. Moreover, the assessors examined a sample of on-site inspection reports and found that the Agency assesses the compliance with risk management requirements provided by the regulatory framework, mainly in relation to Pillar 1 risk (credit, market and operational) and liquidity risk. Moreover, the Agency can exert motivated judgment when assessing risk management an internal control and the assessors were provided with an example where the Agency challenges the inadequacy of a bank's credit risk management system.</p> <p>As regards risk appetite requirements, see CP14, EC5.</p> <p>Banking Law and Risk Management</p> <p>BL 2444 Art. 40-5 requires banks to form a system of risk management and internal control, which includes:</p> <ol style="list-style-type: none"> 1) the powers and responsibilities for risk management and internal control of the board of directors, the management board, the bank's departments, their liability. 2) internal policies and procedures. 3) the limits to the permissible level of risks separately by types of banking operations. 4) internal reporting procedures to the bank's bodies. 5) internal criteria for evaluating the effectiveness of the risk management system. <p>Banking law delegates to the supervisor the task of establishing the secondary regulation of risk management and internal control standards and enables it to carry out the assessment of compliance with these requirements. It also prescribes that the (i) banking groups have a system of risk management and internal control meeting the requirements established by the supervisors and (ii) the parent organization of the banking group ensures compliance with the system of risk management and internal control on a consolidated basis.</p> <p>Resolution n. 188/2019: Rules for formation of risk management and internal control system</p> <p>NBK Resolution n. 188/2019 has the purpose to determine the requirements for the formation of risk management systems and internal control by ensuring effective management risks through their timely identification, measurement, control, and monitoring; appropriate level of business ethics and risk culture; compliance</p>

with the law requirements; timely detection and elimination of deficiencies; creation of adequate mechanisms to deal with unforeseen or emergency situations.

The **board of directors must ensure that the bank's management system matches the selected business model, scale of activity, and complexity of operations**; it shall provide an appropriate process for identifying, evaluating, monitoring, controlling, and minimizing material risks to determine that they are covered by bank's equity and liquidity.

The risk management system shall provide:

- 1) the optimal ratio between the profitability and the level of risks,
- 2) an objective assessment of risks.
- 3) coverage of all types of the bank's activities subject to material risks.
- 4) availability of risk appetite levels for all types of significant risks and the actions in cases of **violation of limits**, including procedures for informing the board and committees.
- 5) awareness of the **collegial bodies making decisions that carry risks**.
- 6) rational decision-making and acting in the interests of the bank, based on the information provided in good faith, and with appropriate diligence and duty of care and loyalty.
- 8) clear distribution of functions, duties, and powers of risk management between all units.
- 9) separation of the risk management and internal control functions from the bank's operations by means three lines of defense system.
- 10) availability of documents to regulate the activities of the bank.
- 11) compliance with the law requirements and internal procedures, processes, and policies.

Moreover, resolution n. 188/2019 par. 37 requires that the head of risk management informs the board of directors and the risk management committee about the methods used and **potential shortcomings of risk management models**.

Resolution n. 189/2019 Rules for formation and use of a motivated judgment

ARDFM might exert motivated judgment when assessing the system of risk management and internal control in a bank. According to Resolution n. 189/ 2019 this can be based on the assessment of:

- 1) risk profile and risk appetite.
- 2) strategic, business model, and risks.
- 3) the quality of forecasting the main financial indicators.
- 4) methods for determining the aggregated level (levels) of the bank's risk appetite and the level of risk appetite for each type of risk for:
- 5) the quality of the system of the bank's corporate management (availability and compliance with the measures on settlement of the conflict of interests; quality of the decision-making process for transactions involving significant risks).

	<p>6) internal procedures for determining the adequacy of capital and liquidity to cover the risks.</p> <p>7) implementation of internal policies, as well as procedures to manage risks.</p> <p>8) procedures to identify related parties.</p> <p>9) procedures for the analysis of collateral.</p> <p>10) effectiveness of credit risk management.</p> <p>11) the quality of internal rating assessment of the borrowers (scoring) of the bank.</p> <p>12) adequacy of provisioning.</p> <p>13) methods for determining the fair value of financial instruments.</p> <p>14) the effectiveness of the bank's funding strategy for:</p> <p>15) procedures for managing the liquidity.</p> <p>16) the effectiveness of the bank's early warning system.</p> <p>17) financing plan in case of unforeseen circumstances and ensuring the continuity of the bank's activities.</p> <p>18) effectiveness of the operational risk management procedures for:</p> <p>19) the effectiveness of the risk management and internal control system of the bank in the field of combating the legalization (laundering) of proceeds from crime and the financing of terrorism.</p> <p>20) stress testing.</p> <p>21) the quality of the management information system.</p> <p>22) functioning of the system of three lines of defense.</p> <p>23) the quality of internal control procedures.</p> <p>24) the effectiveness of the bank's internal audit division when conducting an independent assessment of the effectiveness of risk management procedures.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <p>(a) to provide a comprehensive "bank-wide" view of risk across all material risk types;</p> <p>(b) for the risk profile and systemic importance of the bank, and</p> <p>(c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.</p>
Description and findings re EC2	<p>Resolution n. 188/2019 par 21 requires the Board of Directors to approve, among other things, risk management policies and processes on, among others, credit, market, operational, IT and information security, compliance, AML/CFT, liquidity, collateral (see CP14, EC1).</p>

	<p>Resolution n. 188/2019 par. 6 establishes that when evaluating the effectiveness of the bank's risk management system, the supervisor shall be guided by the following principles:</p> <ul style="list-style-type: none"> • ensuring the financial stability of banks, preventing deterioration of the financial situation, and increasing of risks, protecting the legitimate interests of depositors, creditors, customers, and correspondents of banks. • prevalence of the essence over the form. • proportionality in the exercise of control and supervision functions. • application of a uniform approach to the assessment of the risk management system and supervisory response measures. • identification of significant risks in the activities of the bank. <p>The Agency stated that as part of the annual supervisory process under the SREP methodology, it evaluates (i) the existence of a systematic and periodic process for identifying all material types of risk relevant to assessing capital adequacy; (ii) the required level of capital for all material risks (credit risk, liquidity risk, interest rate risk of the banking book, market risk, operational risk, other material risks) in accordance with the established risk appetite levels.</p> <p>As regard examples of the Agency assessment of banks' risk management, see EC1.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ol style="list-style-type: none"> (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.</p>
Description and findings re EC3	<p>ARDFM pointed out that it includes in its analysis the assessment of the strategic plan, the presence of a documented risk management strategy, and the approval, by the board of directors, of the Operational Risk Framework, the deposits concentration policy, the Interest Rate Risk in the Banking Book management policy, the regular updating of the (group) risk-appetite strategy, capital structure, capital allocation and reward system plans and policies, as well as processes for managing all risks inherent in the bank's activities (credit, liquidity, IRRBB, market, operational and other risks).</p> <p>Resolution n. 188/2019 par. 36 stated that where a decision is made to take a risk that exceeds the established risk appetite levels, the head of risk management shall submit a report on such an exception to the board of directors with a proper analysis of the reasons for the excess and subsequently monitors the reduction of the level of accepted risk within the risk management system and level established by it.</p> <p>ARDFM assesses that risk management strategies, policies, processes and limits are properly documented, regularly reviewed (and adjusted, if needed), and communicated with the bank during off site and on-site supervision. ARDFM</p>

	assesses that exceptions to policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and, where necessary, the bank's Board as part of the off-site supervision: the curator requests and analyzes the management report of the bank.
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	<p>Regulation n. 188/2019 par. 28 states that the Risk Management Committee is responsible, among others, for ensuring the development of an internal procedure that shall determine the functioning of the management information system, which ensures that the board of directors is provided on a regular basis with complete, reliable and timely information about the level of risks taken.</p> <p>The procedure shall include the criteria, composition, frequency, and form of submission to the board of directors of information on the level of risks taken by the bank and its subsidiaries, indicating the structural units and bank agencies responsible for the reporting. The management reporting forms contain information considering the requirements established for ICAAP, ILAAP, business continuity management, IT risk, and security, as well as information on stress testing results, profitability key performance indicators.</p> <p>ARDFM highlighted that its analysis covers issues related to:</p> <ul style="list-style-type: none"> • information to the management board and the board of directors of the quantitative estimates embedded in the ICAAP. • responsibility of the risk management committee (advising to the board). • verification by the board of directors and the management board of events and losses related to operational risk, if material. • holding regular (at least monthly) meetings by the Board of Directors. • availability of a risk appetite strategy or equivalent documents subject to approval, regular monitoring and review by the board of directors and implemented by the management board considering all material risks. • adequate reporting system for liquidity and funding risks. • reporting the results of liquidity stress tests to the Board of Directors. <p>The Agency provided the assessors with on-site inspection reports challenging the comprehensiveness and quality of reporting to the Board of Directors (for example in relation to the methodology for calculating provisioning, as well as on market risk).</p>
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	Resolution n. 188/2019 introduced ICAAP and ILAAP requirements. Although the resolution entered into force in October 2020, banks will submit for the first time ICAAP and ILAAP at the end of April 2023. Therefore, it was not possible for the

assessors to verify how the Agency concretely challenges ICAAP and ILAAP. Such a delay was motivated by the lack of a supervisory methodology for assessing ICAAP and ILAAP, as well as standard forms of ICAAP and ILAAP.

The assessors acknowledge that the implementation of a methodology for assessing ICAAP and ILAAP was one of the main priorities for 2022 (Agency annual report, 2021). In 2022 ARDFM received technical assistance by the IMF (see [here](#) and [here](#)) and, based on IMF recommendations and international experience, the Agency has developed a draft internal methodology for supervisory evaluation of ICAAP and ILAAP, which are considered the main source of information in the implementation of the SREP.

ICAAP and ILAAP Framework

Pursuant to Resolution n. 188/2019 par 38 and 53, the board of directors shall approve an internal document regulates the main approaches and principles of the ICAAP and contains the following sections:

- description of the organizational structure of ICAAP and ILAAP.
- description of the risk appetite strategy.
- organization of credit, market, operational risk management within the framework of ICAAP.
- for ILAAP: liquidity risk and funding management, including daily liquidity risk and liquidity gap; review of the funding strategy and contingency liquidity plan; organization of management of liquidity buffers and collateral.
- organization of stress testing procedures.
- organization of risk management procedures in the framework of new products and activities, including its integration in the liquidity risk management.
- organization of self-assessment procedures for ICAAP and ILAAP.

The organizational structure of ICAAP and ILAAP (Resolution n. 188/2019 par. 40 and 54) shall contain a list of participants indicating the responsibility of the collegial bodies and the units involved in the processes, including:

- a) the board of director responsible for capital management and approving the ICAAP.
- b) the Risk Management Committee responsible for developing risk management policies and procedures, and for notifying the board of directors of significant changes in the level of capital and liquidity.
- c) the unit entrusted with the functions of internal control which should carry out verification of compliance with the ICAAP and ILAAP procedures and bring the results to the board attention.
- d) the risk management unit, responsible for the implementation of the capital and liquidity adequacy management process, preparation of a report on compliance with the ICAAP and ILAAP, conducting stress testing, and developing financing plan in case of unforeseen circumstances.
- e) the internal audit unit that should evaluate the effectiveness of the ICAAP and the ILAAP.

	<p>f) for the ICAAP, also the unit responsible for budget development and planning, as well as the money management unit which should develop and implement measures to increase the level of capitalization.</p> <p>ICAAP and ILAAP should (i) correspond to the risk profile and operating environment of the bank; (ii) be based on proper measurement and evaluation processes, including both quantitative and qualitative elements; (iii) be risk-oriented, covering all significant risks; (iv) be promising.</p> <p>The Agency has also developed draft standard forms of ICAAP and ILAAP assessment reports, which will have to be reflected in Regulation No. 188/2019.</p> <p>The assessors went through the draft supervisory methodology for assessing ICAAP and ILAAP (Order of the Chair of the Agency n. 465. November 2022) and found that it has recently been expanded to interest rate risk in the banking book (IRRBB), by requiring bank to conduct a quantitative assessment of changes in the economic value of equity (EVE) and in net interest income (NII). However, the methodology does not cover other Pillar 2 risks (for example, sovereign). Moreover, the Agency might consider implementing BCBS Principles for effective management and supervision of climate related financial risk (2022) and require banks to incorporate climate risk into their internal capital and liquidity adequacy assessment Processes (Principle n. 5).</p>
EC6	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Banks are not authorized to use internal models for calculating capital requirements. However, Banks use internal models for other purposes (for example, credit due diligence, IFRS 9 implementation, stress testing).</p> <p>Uncertainties attached to the models</p> <p>Reg. 188 requires that the head of risk management shall inform the board of directors of the bank and the risk management committee about the methods used and potential shortcomings of risk management models and analytical approaches in the bank.</p> <p>Independent validation</p> <p>Regulation n. 188/2019 par. 41 requires that banks, within the framework of the credit risk management system, are guided by certain principles and requirements, which include the availability of a procedure for validation credit risk assessment models. Banks shall regulate the processes for validation, back testing, and permissible levels of deviations from the planned level of risks, including, in case of deviation, the development of a plan of corrective measures. Validation shall be carried out using one or more of the following methods: checking the discriminatory</p>

	<p>ability of the model; assessment of the predictive accuracy of the model; analysis of rating migration; comparative analysis of ratings. Validation shall be carried out at least 1 (one) time in 4 (four) years. The frequency of validation depends on the current market situation, strategy, volume of assets, the level of complexity of the bank's operations, and increases in the event of significant changes in the economy or in the bank's internal lending processes. Validation results shall be presented to the risk management committee.</p> <p>The agency pointed out that it carries out inspection on:</p> <ol style="list-style-type: none"> 1) the bank's internal rating system, whether it is adequate to analyze the quality of the portfolio and whether it is used effectively by bank employees. 2) independent validation by the bank of risk measurement and assessment procedures within internal procedures of capital adequacy assessment. <p>The assessors were provided with examples in which the Agency requested bank to enhance the quantitative component of internal models used in the credit due diligence and challenged the lack of independent validation of the models use for calculating expected credit losses (ECL).</p>
EC7	<p>The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.</p>
Description and findings re EC7	<p>As stated in EC4, the Risk Management Committee is responsible, among others, for ensuring the development of an internal procedure that shall determine the functioning of the management information system to ensure that the board of directors is provided on a regular basis with complete, reliable and timely information about the level of risks taken.</p> <p>The agency emphasized that its review includes:</p> <ol style="list-style-type: none"> 1) how the internal audit of internal review procedures for assessing capital adequacy and reporting results to interested employees. 2) whether the risk management committee and board of directors receive regular reports and communications from the risk management unit and the Head of Risk Management regarding credit risk. 3) the extent to which the bank has documented credit risk management processes and policies to identify, measure, evaluate, monitor, report, and control or mitigate all significant credit risks in a timely manner. 4) whether the loan origination system is sufficiently comprehensive (approval, monitoring, and reporting). 5) whether the bank's information systems allow for monitoring and reporting of IRRBB to the board of director and management board. 6) whether the management information system demonstrates high efficiency in carrying out operations and identifying limits breaches. 7) if there a mechanism for immediate notification of operational risk incidents.

	<p>8) if the bank's data architecture and IT infrastructure fully support the integration of risk data and risk reporting not only under normal conditions, but also under adverse conditions.</p> <p>10) whether the Head of Risk Management (or equivalent) has direct access to, and reports to, the board and the risk committee on all risk.</p> <p>11) the quality of the reporting system concerning liquidity and funding risk, including on stress testing.</p>
EC8	<p>The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products,⁴⁵ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.</p>
Description and findings re EC8	<p>Resolution n. 188/2019 par. 8 requires that banks' board of directors should approve the strategy which should contain, among others, the indication of key types of investments, their structure, and planned changes, including the introduction and development of new products and services, considering the assessment of risks and processes associated with their implementation and development, as well as assessing the current capabilities of the bank to introduce and develop such products.</p> <p>Moreover Resolution n. 188/2019 requires banks to ensure the existence of procedures for the development, approval and implementation of new products, activities, processes and systems, or significant changes to existing products, activities, processes, and systems. The procedure should ensure:</p> <ol style="list-style-type: none"> 1) an assessment of the risks inherent in new products, activities, processes and systems of sludge and in the case of significant changes to existing products, activities, processes and systems. 2) analysis of the costs and benefits of implementation. 3) an assessment of changes in levels of risk appetite of the bank and the introduction of appropriate changes. 4) the availability of the necessary control mechanisms. 5) the availability of information on the level of residual risks. 6) the existence of procedures and methods for identifying, measuring, monitoring and controlling risks inherent in new products, activities, processes and systems or in the case of significant changes to existing products, activities, processes and systems. 7) an assessment of the bank's ability to invest in human resources and the technological infrastructure of the bank before introducing new products, activities, processes and systems or in the event of significant changes to existing products, activities, processes and systems.

⁴⁵ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	For supervised organizations, there are information security requirements, which also apply to new implemented solutions. The Cyber Security Department, as part of its supervisory activities, monitors compliance with information security requirements for all implemented assets. The assessor met Agency staff of the Cyber Security department and noted this department needed strengthening; however, this has been weighted under CP 25
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	<p>Pursuant to Resolution n. 188/2019, par. 34, the board of directors must ensure that there is a risk management unit(s) supervised and (or) headed by a head of risk management with sufficient authority, independence, and resources, interacting with the board of directors.</p> <p>The risk management unit is responsible for:</p> <ol style="list-style-type: none"> 1) development of a risk management system, including policies, procedures, risk appetite strategy levels; 2) identification of significant current and potential risks; 3) risk assessment and determination of the aggregated level(s) of risk appetite; 4) monitoring compliance with risk appetite levels; 5) development of early warning systems and triggers aimed at identifying violations of risk appetite levels, and 6) reporting to the management board, the risk management committee, and the board of directors. <p>Moreover, the risk management system shall provide for separation of the risk management and internal control functions from the bank's operations by means of three lines of defense system (Resolution n. 188/2019, par. 5, n. 9). In addition, the Head of Risk Management shall not combine the position of the chief operating director, financial director, other similar functions of the bank's operational activities (except for underwriting, collateral service), and the head of the internal audit unit.</p> <p>The Head of Risk Management must have access to any information necessary to fulfill his/her duties. The interaction between the head of risk management and the board of directors and (or) the risk management committee shall be carried out on a regular basis. The Head of risk Management must have unhindered access to the board of directors of the bank, without the participation of the management board Resolution n. 188/2019, par. 35).</p> <p>ARDFM provided the assessors with:</p> <ul style="list-style-type: none"> • an example of its assessment of the internal audit function (vulnerabilities, insufficient staff, limited competency, inadequate control of the models used for internal management purpose);

	<ul style="list-style-type: none"> n. 3 examples of banks' internal audit of the risk management function (efficacy of risk management and adequacy of internal control system, operational risk management, AML/CFT).
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	<p>As stated under EC9, the board of directors must ensure that there is a risk management unit(s) supervised and (or) headed by a head of risk management. The qualifications and professional experience of the head of risk management shall correspond to the chosen business model, the scale of activity, types and complexity of operations, and risk profile (Resolution n. 188/2019, par. 35). Moreover, the head of risk management shall be appointed and released by the board of directors of the bank. Information on the decision to dismiss the head of risk management shall be passed to the Agency, which could request the board of directors to provide a justification.</p> <p>Resolution n. 188/2019 addressed most findings from the 2014 BCP related to this EC; however, there is still no requirement that the Board removal of the head of risk management should be publicly disclosed.</p>
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	Resolution n. 188/2019 provides for standards on credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk. See concerned CPs.
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	<p>NBK Resolution 188 contains requirements on (i) development and approval of financing plans (see CP24, EC6) and (ii) conducting contingency risk analysis and defining contingency risk management measures. Contingency risk analysis (Resolution 188, par. 66) should cover inaccessibility of employees, technologies (including viruses, computer hardware failure, loss of communication), supply (water, electricity) and key suppliers (contractors), key information, and lack of access to buildings (premises). Contingency risk management measures should cover at least personnel, premises, technology, information, suppliers, contractors, and supply channels.</p> <p>Nevertheless, there are no legal requirements for banks to prepare recovery plans. In 2022 ARDFM received IMF technical assistance which recommended to set clear and comprehensive recovery plans requirements for banks, and to develop and internal methodology, including procedures, documentation requirements and processes to support the supervisory assessment of recovery plans. ARDFM plans to implement these recommendations by the end of 2023.</p>

<p>EC13</p>	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control, on a bank-wide basis; (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management, and (d) is appropriately documented and regularly maintained and updated. <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process</p>
<p>Description and findings re EC13</p>	<p>Pursuant to Res. 188/2019 par. 50, to identify potential risks arising in stressful situations, the bank shall periodically (but at least 1 (once) every six months) conduct stress testing to identify sources of potential threats to capital adequacy.</p> <p>Banks should conduct scenario analysis and sensitivity analysis to analyze the impact of stress scenarios on the level of capital adequacy and assess the level of risk when the internal and external environment changes.</p> <p>The degree and frequency of stress testing is consistent with the chosen business model, the scale of activity, types and complexity of operations, and the role of the bank in the financial system. The bank can increase the frequency of stress testing in worsening market conditions or at the request of senior management.</p> <p>The board of directors is actively involved in the stress testing process by approving procedures, scenarios, evaluating the results and taking measures to minimize the impact on the bank's capital. The board of directors regularly reviews stress testing scenarios for significant changes.</p> <p>When conducting stress testing, the bank uses, but is not limited to, the following stress testing scenarios:</p> <ul style="list-style-type: none"> • general economic scenario, which is based on an assessment of the impact of a decrease in the economic situation in the country, including a decline in economic growth as a whole and in certain sectors of the economy. • a scenario specific to the bank's business, which is based on an assessment of the effect of local stress factors, including those related to the peculiarities of the bank's activity and the structure of its loan portfolio. <p>The bank shall develop stress testing scenarios based on conservative, but plausible scenarios implicating negative changes in external and internal indicators that impinge on the capital adequacy. The validity of the choice of scenarios and relevant assumptions is documented and considered along with the results of the stress test.</p>

	<p>In determining stress scenarios and sensitivity, the bank shall use a wide range of information, including historical and hypothetical stressful situations.</p> <p>In addition to the possibility of applying the stress scenarios used by the regulator, the bank seeks to use the most applicable stress situations that correspond to its individual characteristics. In developing scenarios and assumptions of stress testing, the bank is guided by the following:</p> <ul style="list-style-type: none"> • scenarios include all significant risks to which the bank is potentially exposed. • the bank shall (i) consider the relationship of various types of risks; (ii) takes a conservative approach in determining the assumptions of stress testing; (iii) consider short-term and protracted, as well as idiosyncratic and market scenarios, regardless of how high the level of capital adequacy is at the moment, including: lack of access to capital markets; reduction in the cost of energy; depreciation of the national currency; real estate market crisis; change in rates; agricultural crisis; rising inflation expectations; increasing unemployment and lower incomes; decrease in market value of assets. <p>The results of the stress test as well as subsequent actions to minimize the negative impact, are communicated and discussed with the board of directors of the bank and departments involved in the liquidity risk management process. The board of directors of the bank shall integrate the results of the stress testing process into the strategic and budget planning process of the bank. The results of stress testing shall be used to establish internal limits. The board of directors shall consider the results of stress testing in the process of maintaining capital adequacy in the event of unforeseen circumstances, including the eliminating of the shortcomings of the process.</p> <p>As stated under CP9, EC4, the ARDFM plans to assess banks' bottom-up stress test capability in the context of the ICAAP review, whose implementation is ongoing (April 2023 represented the first ICAAP submission). This will make it possible to verify banks' stress testing programs, their ability to capture material source of risks and to integrate the stress test results into decision making.</p>
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	The Agency performs verification with regard to implementation of the Internal Transfer Pricing Mechanism in the bank and evaluation of the risk appetite structure or equivalent document in the process of approval of new products or business lines of the bank.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	
Assessment of Principle 15	Largely Compliant
Comments	The regulatory framework for risk management has been strengthened in 2019, through NBK Resolution n. 188, which sets requirements for the formation of risk management systems and internal control by the bank. This Resolution addressed

	<p>multiple deficiencies identified by the 2014 BCP, namely by introducing the requirements that:</p> <ul style="list-style-type: none"> • uncertainties attached to risk measurement are recognized (par. 37). • exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary (par. 36). • independent validation of models. • board approval of new products and services through the approval of strategy (par. 8). • the establishment of the head of risk management (equivalent to the CRO) and the safeguards for his/her removal (board of directors' approval, and discussion with the supervisor), even though there is no requirement that the removal should be publicly disclosed. <p>Nevertheless, there are no legal requirements for banks to prepare recovery plans.</p> <p>ARDFM can exert motivated judgment when assessing the risk management function and provided the assessors with sufficient evidence of implementation of it. However, a key test for the motivated judgment will be the supervisory assessment of ICAAP and ILAAP which, however, had not been submitted yet by the banks at the end of the mission).⁴⁶ Supervisory expectations need to be expanded to the entire spectrum of Pillar 2 risk (for example, sovereign), including those new and emerging (climate risk) which should be embedded in the ICAAP and ILAAP.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Introduce requirements for banks to prepare recovery plans. • Prioritize the assessment of ICAAP and ILAAP.
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Principle 16	Capital adequacy. ⁴⁷ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor

⁴⁶ The first submission of ICAAP and ILAAP took place at the end of April 2023, after the end of the FSAP mission.

⁴⁷ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>The capital adequacy framework is enshrined in:</p> <ul style="list-style-type: none"> • Banking Law art. 41, enables the supervisor to regulate the banks' activities, including through establishment of prudential standards and other mandatory standards and limits, to ensure financial stability, protect interests of depositors, and maintain stability of the monetary system of the Republic of Kazakhstan. • Banking Law art 42, that envisages among the structure of prudential standards established by the supervisor, (i) the minimum amount of the authorized capital of the bank; (ii) the minimum amount of the equity capital of the bank; (iii) the equity capital adequacy ratio. • NBK Resolution n. 170/2017, <i>"About establishment of normative values and techniques of calculations of prudential standard rates and other regulations and limits, obligatory to observance, size of the capital of bank and Rules of calculation and limits of open foreign exchange position."</i> <p>Capital Requirements</p> <p>Kazakhstan transitioned to Basel III and banks operate under credit risk standardized approach, market risk standardized approach, operational risk basic indicator approach (BIA).</p> <p>The Agency has not conducted an assessment on whether any modifications to the capital requirements are needed in relation to the new Basel framework which entered into force in January 2023. The assessor found the local RWA for credit risk are in some cases more conservative than those provided by the new standardized approach (for example, consumer lending, mortgage). However, in other cases the methodology is less conservative: for example,</p> <ul style="list-style-type: none"> • exposure to SME are risk weight 50 percent instead of 75 percent. • exposures to legal entities in tenge with the form of syndicated loans are risk weighted by 50 percent, regardless of the rating. <p>The Agency pointed out that these measures were temporary: the capital support measures were introduced back in March 2020 and rolled over twice until December 2023. However, from January 1, 2024, the risk weights for exposures to SME and to legal entities in tenge in the form of syndicated loans will be re-aligned with Basel: ARDFM board did not further extend these temporary risk weights.</p> <p>Moreover, exposures to multilateral development banks (MDBs) with a rating not lower than "AA-" and from "A+" to "A-" are risk weighted, respectively, 0 percent instead of 20 percent and 20 percent, instead of 30 percent. ARDFM clarified that, since most of the MDBs have a rating of "AAA", the risk is not material (only two minor regional MDBs fall into that rating range and the Kazakhstani banks' exposure to those MDBs are negligible). Nevertheless, the Agency will consider changing these risk weights to be fully compliant with the Basel requirements.</p> <p>It should be noted that the materiality of exposures carrying a more conservative prudential treatment is higher than of exposures benefitting from a preferential treatment (consumer lending constitutes the largest share of the banks' total loans).</p>

	<p>The operational risk capital requirements under the BIA are less risk sensitive than the new standardized approach, as it does not incorporate banks' operational losses experience. ARDFM collects on a quarterly basis banks operational losses above the threshold of 500.000 KZ tenge and might consider moving to the new framework.</p> <p>Along with the minimum capital (see EC5, CP6), NBK Resolution n. 170/2017 provides for the:</p> <ol style="list-style-type: none"> 1) coefficient of fixed capital - k1: 5.5 percent. 2) capital adequacy ratio of first level - k1-2: 6.5 percent. 3) coefficient of equity of k2: 8 percent (total capital). <p>The denominator of the three ratios is the same: RWA for credit and market, plus operational risk capital requirement under the BIA. The numerator instead changes, being the fixed capital for the coefficient under n. 1); the capital of the first level (fixed capital + added capital) for the ration under the n. 2); and the equity for the coefficient under n. 3). In substance, the three indicators correspond to CET1, AT1 and T2 ratios.</p> <p>The assessors examined the qualifying component of capital and noted that the only deviation from Basel Framework relates to revaluation reserves, which however are very limited in amount (0.6 percent of total capital) (see EC2).</p> <p>In addition, the following buffers are in place:</p> <ul style="list-style-type: none"> • Capital conservation buffer (CCB): 2 percent for all banks and 3 percent for domestically systemically significant banks (D-SIB) – which are the only internationally active banks in Kazakhstan. • systemic buffer 1 percent of the sum of assets, conditional and potential liabilities, weighted taking into account risks. • countercyclical buffer (CCyB), the size and timing of which is established by Resolution № 170 no later than 12 months before the start date of calculation. It ranges from 0 percent to 3 percent of the sum of assets, conditional and potential liabilities, weighted taking into account risks. <p>CCB for banks other than D-SIB was reduced to 1 percent during the Covid-19 pandemic; as the economy recovered, the Agency restored to 2 percent.</p> <p>There is no approved methodology for setting the CCyB. However, NBK carries out a regular monitoring of the need to set a CCyB. The buffer was not activated.</p> <p>Moreover, a Debt Service to Income Ratio (DSTI) is in place: the ratio of the amount to monthly payment on all outstanding loans of the borrower, including the amount of overdue payment and the average monthly payment on new debt of the borrower to the average monthly income of the borrower for the last six months should not exceed 0,5.</p>
EC2	<p>At least for internationally active banks,⁴⁸ the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.</p>

⁴⁸ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

Description and findings re EC2	<p>The definition of capital is broadly compliant with the applicable Basel standards. One exception is the revaluation reserve (both on fixed assets, of the cost of the securities carried at fair value through other comprehensive income) that are included into the <u>fixed capital</u>. However, based on the information provided by the Agency, their amount is limited (0.6 percent of total capital).</p> <p>Between 2015 and 2020 the Agency has also phased out the computability of preferred shares and subordinated debt instruments which do not meet the criteria for inclusion in Tier 2 capital, e.g., the clause that requires that at the option of the Agency, the instruments can either be written off or converted into common equity upon the occurrence of a trigger event. The new subordinated debt instruments are <i>bail-inable</i> and their early repayment is subject to supervisory authorization; they represent about 17.5 percent of the total capital.</p> <p>As regard the risk coverage and the method of calculation see EC 1.</p>
EC3	<p>The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions)⁴⁹ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.</p>
Description and findings re EC3	<p>The Agency has the power to impose specific capital charge; however, there is no active securitization market (only one operation in 2017). Therefore, the assessors did not scrutinize the securitization framework.</p> <p>Capital requirements include also contingent liabilities based on the credit conversion factors provided by Appendix n. 6 NBK Regulation n. 170/2019.</p>
EC4	<p>The prescribed capital requirements reflect the risk profile and systemic importance of banks⁵⁰ in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.</p>
Description and findings re EC4	<p>Capital requirements do not properly reflect the banks' risk profile, as they are set at the same level for all banks.</p> <p>ARDFM has drafted a methodology for Pillar 2 capital add-on, but the roll-out is planned for 2024. The draft methodology covers IRRBB and capital shortfall resulting from under provisioning. It does not cover the other Pillar 2 risks, (for example, sovereign and climate).</p> <p>Capital requirements reflect instead the systemic importance of banks as a systemic risk buffer (1 percent of RWA) is in place for the three identified Domestically Systemic Important Banks (D-SIB). The size of this buffer was determined considering the performance of D-SIB and banks with a lower level of equity and assets in a</p>

⁴⁹ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

⁵⁰ In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>stress test scenario. The difference between the median value of reduction of capital adequacy ratio in the implementation of the stress scenario for large banks and the median value of reduction of the ratio k1-2 of other banks was taken as the level of systemic buffer (1 percent). Moreover, for D-SIB a higher CCB is in place.</p> <p>A leverage ratio requirement is not in place, but its introduction will be considered in 2024. Currently the Agency is analyzing the Basel rules on calculation of the leverage ratio and is planning to assess the current level of leverage ratios for banks accordingly.</p>
EC5	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so, and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	<p>Banks are not authorized to use internal models for calculating capital requirements. Subsidiaries of foreign banks (for example, Citibank, Industrial and Commercial Bank of China) calculate capital requirements under the standardized approach.</p>
EC6	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).⁵¹ The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	<p>ARDFM has the power to require banks to adopt a forward-looking approach to capital management, as Resolution n. 188/2019 introduces ICAAP requirement (CP 15), which will also include banks' internal stress testing. However, although the Resolution entered into force in October 2019, due to the lack of an ICAAP template and a supervisory methodology to assess ICAAP, banks will submit their first ICAAP in 2023. As regards supervisory stress testing see CP 9.</p> <p>Power under point b) is lacking, as the recovery plan requirement is not in place.</p>

⁵¹ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁵²
Description and findings re AC2	
Assessment of Principle 16	Largely compliant
Comments	<p>Kazakhstani banks transitioned to Basel III and calculate capital adequacy requirements under the credit and market risk standardized approach, and the operational risk basic indicator approach (BIA). The Agency has not conducted an assessment on as to whether any modifications to the prudential framework are needed in relation to the new Basel framework which entered into force in January 2023. Local risk weights for credit risk are in some cases more conservative than those provided by the new standardized approach (for example, consumer lending), but in other cases less conservative (exposures to SME, syndicated loans in tenge, and exposure to MDB).</p> <p>The definition of capital is broadly compliant with the applicable Basel standards, with the exception of the revaluation reserves—which, however, represent just 0.6 percent of total capital. The computability of non <i>bail-inable</i> subordinated debts into the Tier 2 has been phased out between 2015 and 2020.</p> <p>CCB for non D-SIBs is set at 2 percent instead of 2.5 percent; no leverage ratio requirement is in place, but the ARDFM will consider its introduction in 2024. Capital requirements do not reflect the banks' risk profile yet: ARDFM has drafted a methodology for Pillar 2 capital add-on, but the roll-out is planned for 2024. The draft methodology covers IRRBB and capital shortfall resulting from under provisioning, but it does not cover other Pillar 2 risks, (for example, concentration, sovereign, climate-related financial risks).</p> <p>The assessors considered that the more conservative risk weighted assets for consumer lending adequately compensate for the less conservative risk weighted assets in place for SME and syndicated loans in tenge:</p> <ul style="list-style-type: none"> • consumer lending is indeed a higher percentage of banks total loans than SME lending and syndicated loans in tenge, as it accounts for the largest share of the banks' total loans; • moreover, risk weights for consumer lending could reach 350 percent (as opposed to 75 percent prescribed by the Basel framework), which is a material add on, higher than then reduction of risk weighted assets on exposure to SME (50 percent instead of 75 percent). <p>Furthermore, from January 1, 2024 the ARDFM will realign risk weights for exposures to SME and to legal entities in tenge in the form of syndicated loans with the Basel</p>

⁵² Please refer to Principle 12, Essential Criterion 7.

	<p>framework. In addition, as clarified by the ARDFM exposure to MDB with a rating below AAA are negligible and ARDFM is considering changing these risk weights to be fully compliant with the Basel requirements.</p> <p>All these considerations, along with the phasing out of non <i>bail-inable</i> subordinated debts, contributed to the decision to assign a LC score.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> • Phasing out the residual Covid-19 capital forbearance measures (align RWA calculation for exposures towards SME and syndicated loans with Basel framework). • Eliminate revaluation reserves from the eligible items in the definition of capital. • Introduce a leverage ratio requirement. • Increase CCB to 2.5 percent also for non-D-SIBs. • Calibrate prudential requirements to risk profile by implementing the draft Pillar 2 methodology. • Expand methodology and Pillar 2 add on to concentration, sovereign, and climate related financial risk.
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Principle 17	Credit risk. ⁵³ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁵⁴ (including counterparty credit risk) ⁵⁵ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	Regulation n. 188/2019 par. 41 requires bank to ensure the existence of an effective credit risk management system that meets the current market situation, strategy, size and of complexity of operations and ensures the effective identification, measurement, monitoring and control of credit risk to ensure that bank's own capital is sufficient to cover it.

⁵³ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁴ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁵⁵ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	<p>An effective credit risk management system should have the following component:</p> <ul style="list-style-type: none"> • the procedure for the adoption of relevant decisions. • the credit administration procedures. • the credit risk assessment procedures. • credit monitoring. • collateral management. • troubled loan management. • assessment of the effectiveness of the credit risk management system. <p>ARDFM assesses that the credit management system is consistent with the risk appetite, risk profile, systemic importance, and capital strength of bank during the SREP process and on-site inspections. As stated under CP9 the inspection function is robust, and findings are incisive, even though they need to be prioritized.</p>
EC2	<p>The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,⁵⁶ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.</p>
Description and findings re EC2	<p>As stated under CP14, EC1, the management board is responsible for developing the credit policy, for the submission to the risk management committee and the board of directors' approval. The board should also approve the risk management policy.</p> <p>Regulation n. 188/2019 par. 42 requires the <u>board of directors</u> (and the risk management committee) to ensure, among other things, the control of the credit risk assessment process by:</p> <ul style="list-style-type: none"> (a) ensuring the completeness and reliability of information (b) guaranteeing compliance with the requirements of civil, tax, banking law, law on accounting and financial reporting, credit bureaus, and internal policies and procedures (c) ensuring complete and reliable management, regulatory and financial reporting (d) safeguarding the existence of a loan assessment procedure by the business units (e) availability of procedures for interaction between participants in the credit risk management process (f) effective internal control system <p>The Agency pointed out that it assesses the board and senior management roles in relation to credit risk in the context of the SREP. In accordance with the SREP</p>

⁵⁶ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<p>methodology, the qualitative analysis of the Risk Assessment (under the Corporate Governance category) includes issues related to:</p> <ul style="list-style-type: none"> • board approval and regular updates to the strategy (group), risk appetite structure, capital plan, internal capital allocation and remuneration system plans and policies, and processes for managing all risks. • availability of risk appetite strategy or equivalent documents subject to approval, regular monitoring and review by the board of directors and implemented by the management board, considering all risks. <p>The assessors examined two risk assessment /SREP and several on-site inspection reports and found that the Agency assesses the board’s approval and review of credit risk policies and processes.</p>
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ol style="list-style-type: none"> (a) a well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower’s ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank’s Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank’s risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank’s senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings re EC3	<p>Regulation n. 188/2019 par. 42 provides requirements on credit risk policies and processed, as well as on the control risk environments.</p> <p>(a) Strategy and sound policies, without undue reliance on external credit assessments</p> <p>Bank shall carry out credit activity and credit risk management within the framework of the approved credit policy, which includes, at least the main directions of the</p>

<p>bank's credit activity, the internal procedure for making credit decisions (including for loans to related parties, credit limit, and the procedure for analyzing the creditworthiness of the borrower.</p> <p>Banks operate under the credit risk standardized approach, but corporates are mostly unrated. When it is necessary to use external expert assessments, the bank shall ensure a regulated process, with limits to its use, a sufficient level of competence of expert assessors and a unified approach (under the same conditions, expert assessments shall not have significant deviations). Expert assessment shall be carried out based on reasonable and documented assumptions, with due care. Historical data shall be supplemented by an analysis of the current market and economic situation, changes in the processes of granting loans, standards and practices; changes in external and internal economic factors and business environment; changes in the level of non-performing and restructured loans; emergence of new market segments and products; concentration of credit risk.</p> <p>(b) Criteria and policies and processes for approving new exposures (including prudent underwriting standards)</p> <p>Credit due diligence requirements are differentiated depending on (i) the amount of the loan and (ii) the type of borrower (individual versus legal entity).</p> <p>Loans (and contingent liabilities) to <u>individuals</u></p> <p>For loans exceeding 0.01 percent of the bank's capital and 100 billion KZT, or below 100 billion KZT but above 0.02 percent of the bank's capital, the creditworthiness analysis should be based on (but not limited to): borrower's income, real estate and other property; availability of loan debt, including to other creditors; payment discipline (credit history); rating in the scoring systems (if any); other debt; sources of debt repayment; balances and operations on bank accounts; information about education and employment (field of activity); socio-demographic characteristics; information about the intended use of money; additional information about the borrower's income. For loans not exceeding the above thresholds, the creditworthiness analysis should be based on the same information, but it may not consider real estate and other property.</p> <p>Loans (and contingent liabilities) to <u>legal entities</u></p> <p>For loans exceeding the same above thresholds, the creditworthiness analysis should be based on (but not limited to them): analysis of financial statements and main financial ratios (profitability, leverage, cash flow) and incomes level; availability of loan debt, including to other creditors; payment discipline (credit history); level of liquid assets; debt load; availability of other sources of debt repayment; forecast free cash flows; borrower's external environment (state of economy, industry, development prospects, diversification of production and sales markets, operating activities, market share, products, geography of operations, business cyclicity, changes in consumer preferences and technologies, barriers to entry and other factors affecting the company's ability to generate income and maintain prices); quality of the management (experience, competence, business reputation), owners, involvement in litigation; inclusion in the list of unreliable taxpayers.</p> <p>For loans not exceeding these thresholds, the creditworthiness analysis can be simplified, for example, without conducting the analysis of the financial statement as well as the corporate governance of the legal entity, even though the set of</p>

quantitative and qualitative indicators varies depending on the lending industry and the type of borrower,

The assessors noted a deficiency: banks' credit policy '*shall determine the cases (issuance of bank guarantees, letters of credit, bank guarantees issued against a bank counter-guarantee, as well as loans secured by highly liquid assets) in which the analysis of the borrower's creditworthiness is not applied*'. Exemptions from credit due diligence requirement should not be tolerated or even solicited by the regulation (the availability of the collateral is not an excuse to escape due diligence).

Subsidiaries of non-resident banks of the Republic of Kazakhstan with a Standard & Poor's long-term credit rating not lower than "A-", or a rating of a similar level by another rating agencies, can use the parent company's creditworthiness analysis, provided that the analysis was carried out no later than 12 months from the date of the borrower's request.

(c) Credit Administration

Banks shall carry out **credit administration** in accordance with procedures that include, at minimum compliance of documents with the conditions for granting; compliance of loan agreements with the adopted decisions; formation and maintenance of a credit dossier. The credit dossier, which can also be held in electronic form, should contain:

- documents for identification of the borrower (including for legal entity the disclosure of the ultimate owners or individuals who own, directly or indirectly, ten or more percent of shares), confirmation of his/her legal personality, as well as documents confirming the powers of persons acting on behalf of the borrower and authorized to sign credit and collateral documents.
- documentation related to the intended use: information on the purpose of the financing (including the initial objectives in the event of restructuring and (or) refinancing) and documents confirming the purpose of using the loan, including for legal entities - contracts of supply, purchase-sale, foreign trade contract. Nevertheless, for overdrafts, consumer loans without confirmation of the intended use in the aggregate amount of less than 0.2 percent of the bank's own capital and loans for the purpose of replenishment of working capital with an aggregate amount of less than 0.2 percent of the bank's own capital, syndicated loans with the participation of non-resident banks of the Republic of Kazakhstan, there is no requirement on the intended use.
- a feasibility study (for loans and contingent liability to legal entities exceeding, (i) 0.1 percent of equity, for banks with equity capital above 100 billion KZT, (ii) 0.2 percent of equity, for banks with equity capital below 100 billion KZT) containing the payback period and the level of profitability of the transactions, or the borrower's business plan, with the description of the activity indicating the purposes the loan, sales and marketing strategy, an assessment of risks and their management, a detailed financial plan, an estimate of incomes and expenses.
- Documentation required for credit monitoring, generated by the bank during the credit relation or required to confirm periodic monitoring, as well as the procedure for updating information about borrowers.

An internal procedure should determine the types of **collateral** and criteria for their acceptability; requirements for the structure of the collateral; limits; share of highly liquid collateral; a coefficient characterizing the ratio of the loan amount to the value of the collateral; procedures ensuring the legal effect (enforceability) of collateral; assessment of its adequacy, considering changes in the indicators of the borrower's production activity; the cost and safety of collateral, including its exposure to other circumstances that significantly affect its assessment; procedures for the sale of collateral, including deadlines; objectivity (adequacy) of assessment of the value of collateral by appraisers. For loan collateralized with real estate, the bank must consider the results of the assessment and when the market value, determined as of the date of the last appraisal, is more than 100,000 monthly calculation indices (equivalent to US \$ 750k), the bank shall provide (at least 1 time per year) the appraisal of the collateral by the appraiser.

(d) Effective information System

Banks must develop forms of management reporting, which at minimum includes information on the loan portfolio and its quality, including trends; the exposure to credit risk and warning when the current exposure is reaching the internal limits (pre-limit approach); exposure to a group of related borrowers and its dynamic.

concentration to the largest borrowers and related parties, including shareholders, and dynamics of its change; internal ratings of borrowers; monitoring the quality of loans by ratings; adequacy of provisioning; restructured, refinanced and problem loans; compliance with limits; deviations from policies and limits.

(e) Limits

The documents governing credit risk transactions should include, among other things, **credit limits** Lending limits, including for unsecured loans shall be established by currencies, industries, categories of borrowers (counterparties) (financial institutions, corporate, retail lending), products, groups of related parties and per borrower.

(f) Exception tracking

Credit risk decisions should be made in compliance with the internal control rules. In case of **deviations** from the established internal procedure, the divisions concerned shall bring the information to the bank's board of directors. To avoid significant deviations in the bank's activities, the board of directors shall establish restrictions on the volume (loan amount) and (or) on the number of deviations and carry out control over compliance with the established restrictions.

(g) Effective control around the use of models

The board of directors shall determine the responsible divisions for development of the rating model and (or) scoring system, their implementation, application, and **control**. The rating model and (or) scoring system contain a description of each level of credit risk and the conditions for their assignment, which should consider the borrowers' financial situation and other available and up-to-date information.

The credit rating assigned to legal entities shall be subject to periodic monitoring for relevance. The frequency of revision increases in the case of negative information that carries the risk of deterioration in the financial conditions of the borrower and (or) impossibility of repay obligations.

	<p>AFDRM determines that policies and processes establish an appropriate and properly controlled credit risk environment mainly through approval of methodology for the calculation of provisions and during on-site inspections. Credit risk models are also challenged in the framework of the regular AQR. The Agency is developing a methodology of capital add-on that will include SREP and regular AQR results. However, despite the tightened capital requirements, the growth rate of consumer lending (about 40 percent in 2021 and 27 percent in 2022) remains a source of concern. During discussions with the mission counterparts, it emerged that in some cases banks grant consumer loans for an improper use (for example to enable the borrower to make the minimum down payment on mortgage, or for repayment of overdue debt, including with other financial institutions).</p>
EC4	<p>The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.</p>
Description and findings re EC4	<p>Due diligence requirements include the assessment by the banks of 'other debt' of the borrowers. In Kazakhstan there is one credit registry which is managed by NBK. Banks report to the credit registry all loans (there is no threshold), but they cannot access it. The Agency can access the credit registry.</p> <p>To assess the total indebtedness, banks should purchase information from the two existing credit bureaus (one public, also managed by NBK; the other private). The Credit Register is more focused on supervisory purposes, while the databases of credit histories formed by credit bureaus contain more detailed data on borrowers. The Credit Register covers banks and does not cover microfinance activities, which are needed when assessing credit worthiness.</p> <p>Notwithstanding the different scope between credit registry and credit bureaus, there is room to better exploit the public good intrinsic in credit registry set of information, by for example conducting analysis on how the same borrower is classified by different banks and sharing some results with the banking system.</p>
EC5	<p>The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.</p>
Description and findings re EC5	<p>Resolution n. 188/2019:</p> <ul style="list-style-type: none"> • defines 'conflict of interests' a situation in which there is a contradiction between the personal interest of the bank officials, its shareholders, employees and other interests of the bank, employees, customers, which will entail adverse consequences for the bank or its customers (par. 2 n. 17). • prescribes that the organizational structure of the bank shall minimize the conflict of interests and distributes risk management powers between collegial bodies and structural units (par. 20). <p>Moreover, the draft code of corporate governance approved by the general meeting of shareholders should include a procedure to manage conflict of interest, as well as control over its implementation (CP14 EC5). This procedure shall contain a mechanism for minimizing a conflict of interest, including obligation of members of the board of directors to abstain from voting on issues within which the member has a conflict of interest.</p> <p>The Agency argued that it verifies availability of a full-fledged conflict of interest policy in the bank, including providing for compliance with the principles of professional ethics while performing its activities.</p>

	See also CP20.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>Regulation n. 188/2019 subparagraphs 20) and 21) requires that the Board approve the following credit decisions:</p> <ul style="list-style-type: none"> • loans exceeding 5 (five) percent of the bank's own capital on the basis of analysis and assessment of the advisability of issuing a loan. • unsecured consumer loan exceeding 20,000,000 (twenty million) KZT based on analysis and assessment of the feasibility of issuing a bank loan. This requirement does not apply to refinancing mortgage loans. <p>Moreover, the decision to restructure loans for borrowers (or a group of related borrowers) due to financial difficulties, (for the definition, see CP18) which total debt, including contingent liabilities, exceeds 1 (one) percent of the bank's own capital—the amount of which is more than 100 (one hundred) billion KZT—or 2 (two) percent of the bank's own capital—the amount of which is up to 100 (one hundred) billion KZT—is adopted by the bank's board or an authorized collegial body of the bank, which includes the chairman of the bank's board. Information on the decisions made shall be sent on a quarterly basis to the members of the bank's board of directors. Information on the decisions made shall be sent on a quarterly basis to the members of the bank's board of directors. The decision should be based on the availability of prospects for repayment of the loan after the restructuring.</p>
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	ARDFM has full access to information in the credit and investment portfolios and to the bank officers. The Agency's representative has the right to request information and documents in oral and written form, including financial statements and materials of meetings (see CP9, EC7).
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	<p>Resolution n. 188/2019 par. 50) requires banks to conduct periodically, at least 1 (once) every six months, stress testing to identify sources of potential threats to capital adequacy. Stress testing scenarios should consider either general economic condition (for example, decline in economic growth) or idiosyncratic factor related to the peculiarity of the bank's business, and must be conservative enough to affect the capital adequacy. The board of directors should approve scenario and result of stress testing, integrating them into the strategic and budget planning. It should also regularly review the scenarios. Scenarios include all significant risks to which the bank is potentially exposed including factors affecting credit risk (for example, real estate market crisis; agricultural crisis; rising inflation expectations; increasing unemployment and lower incomes; decrease in market value of assets).</p> <p>ARDFM pointed out that during the SREP it verifies the existence of a credit risk stress-testing program and the use of stress-testing tools. At the same time, in the course of inspections an analysis of stress-testing procedures is carried out, taking into account its current activities, business model and market environment, the</p>

	results of which should, be subject to review by the management body and considered to determine the bank's risk appetite, its strategy and business planning.
Assessment of Principle 17	Largely Compliant
Comment	<p>Despite the tightened capital requirements, the growth rate of consumer lending (about 40 percent in 2021 and 25.3 percent in 2022) remains a source of concern, due to the lack of clarity on the underlying drivers. During discussions with the mission counterparties, it emerged that some banks are loosening underwriting standards (for example, granting of consumer loans to enable borrowers to make the minimum down payment on mortgage loans, or repay overdue debt, including with other financial institutions).</p> <p>Regulation n. 188/2019 has strengthened the credit risk management framework. However, there is still room for improvement. For example, Regulation 188/2019:</p> <ul style="list-style-type: none"> • does not cap the maxim amount of a consumer loan in absolute term (and not only in relation to the borrower income) and this might open windows of opportunity for unintended use of consumer loans. • enables banks to '<i>determine the cases (. . .loans secured by highly liquid assets) in which the analysis of the borrower's creditworthiness is not applied.</i>' Exemptions from credit due diligence requirements should neither be tolerated nor solicited by the regulator (and the availability of the collateral is not an excuse to escape due diligence). • Envisages a threshold for annual assessment of the real estate collateral which is too high (equivalent to US 750k \$). • Lacks a specific requirement for the assessment of significant unhedged foreign exchange risk and its impact on credit risk. • Is silent on the evaluation method of the collateral. <p>Recommendations</p> <p>The Agency should (i) perform a closer oversight of consumer lending and apply measures to those banks that do not strictly monitor the adequate use of those loans, and (ii) consider capping the maxim amount of a consumer loan in absolute terms; (iii) eliminating exceptions to banks' due diligence; (iii) reducing the threshold for annual assessment of the real estate collateral and prescribe the use of more than one methodology; (iv) requiring the assessment of unhedged foreign exchange risk and its impact on credit risk.</p>
Principle 18	Problem assets, provisions and reserves. ⁵⁷ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁵⁸
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the

⁵⁷ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁸ Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>The regulatory framework on problem assets, provisioning and reserves is enshrined in the following acts:</p> <ul style="list-style-type: none"> • BL 2444 art. 43 which requires banks to establish provisions (reserves) in accordance with the international financial reporting standards and empowers ARDFM to assess the adequacy of provisions, including by using the “motivated judgment.” • Law 474-II art. 13-5 which identifies the assessment of the adequacy of provisions (reserves) of a bank as one of the five area in which the authorized body (ARDFM) has the right to use motivated judgment. • Resolution n. 188/2019 which requires: <ul style="list-style-type: none"> a) the board of director to approve the policy on problem assets (par. 21 n. 5). b) banks to have in place reliable methodology for the formation of provisions and annually (or more often if needed) review it (par. 42. 4). c) banks’ <u>board of director</u> and the <u>Risk Committee</u> to ensure: <ul style="list-style-type: none"> (i) the maintenance of a sufficient level of provisions, (ii) the approval of an adequate system for classifying assets by the level of credit risk, and (iii) an assessment of compliance of the level of provisions with expected losses within the framework of the internal methodology for the formation of provisions, as well as the internal process for assessing capital adequacy (par. 42 n. 1). • Resolution n. 269 Dec. 2017 (<i>‘Rules for creating provisions (reserves) in accordance with international standards of financial reporting and requirements of the legislation of the Republic of Kazakhstan on accounting and financial reporting’</i>) which implemented IFRS9 expected credit loss (ECL) framework. It requires banks to develop and approve the Methodology for calculating provisions (reserves) which must be agreed with the supervisor (Res. n. 269 par. 4). IFRS 9 is effective as of January 2018, and the transition was prepared with the support of the big four audit companies. No “parallel run” with the “incurred credit loss” method has been in place; moreover, accounting standards are the only one within which banks calculate provisioning, as no prudential backstops have been kept (minimum reserve requirements depending on the prudential classification of loans).
EC2	The supervisor determines the adequacy of a bank’s policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor’s opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank’s policies and processes
Description and findings re EC2	ARDFM conducts an annual supervisory process of risk assessment of banks using the SREP methodology, which, among other things, verifies the existence of policies

and procedures for early identification of troubled assets. Moreover, as part of the assessment of the risk management system, the Agency conducts inspections to assess the bank's methodology for calculating provisions to ascertain compliance with IFRS, including reasonable and adequate reserves for assets and mathematical models used to determine the provisioning rates for portfolios of loans subject to collective provisioning and the degree of its automation. Involvement of external experts took place during the AQR 2019.

Policies and processes for classifying assets

One of the requirements of the credit risk management system is the availability of an **adequate system for classifying assets by the level of credit risk** (Resolution n. 188/2019 par. 42 n. 5).

Banks shall implement and use complex procedures and information systems to monitor the quality of the loan portfolio, including criteria that identify and reveal problem loans and ensure proper control.

The system for classifying assets by the level of credit risk shall be based on a detailed analysis of all assets (*excluding receivables from non-core activities in an amount not exceeding 2 percent of the bank's own capital*), including an assessment of: the probability of default (PD); the amount of losses in case of default (LGD); the exposure at default (EAD); the maturity; the cost of collateral and the possibility of its sale; the business environment and economic conditions.

The **classification of assets** (*excluding receivables from non-core activities in an amount not exceeding 2 percent of the bank's own capital*) is **carried out based on at least 5 (five) categories** and ensure: a reliable assessment of capital adequacy within the ICAAP, and the required level of provisions to cover the expected losses. However, ARDFM does not spell out these five categories and **classification and provisioning rules follow IFRS 9**.

Assets for which there is an overdue debt on the principal debt and (or) accrued interest for a period of more than 90 calendar days shall be classified in the worst categories if there are no compelling and reasonable grounds for classification into a higher category. Assets for which there is an overdue debt on the principal debt and (or) accrued interest for a period of less than 90 calendar days shall be classified in the worst category, if there are other factors of the borrower's insolvency determined by internal documents.

The Agency has not reconciled the prudential framework, which requires banks to classify assets based on at least 5 (five) categories, with the accounting framework, that is based on the IFRS 9 three stages process (see EC 5).

The assessors went through on-site inspection reports and found that the Agency challenged the inappropriate approach for calculating provisioning, deviating from IFRS 9, and required banks to correct such deviations. The outcomes of the AQR are integrated into supervisory planning endeavors. Provisioning levels and credit risk models are challenged in the framework of the regular AQR, whose methodology is based on IFRS 9; however, the assessors found that AQR-based provisioning of retail lending was lower than that adopted by banks, which points to the need to review the assumptions used in the AQR to ensure that they are not systematically less conservative than banks' estimates.

EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁵⁹
Description and findings re EC3	<p>Resolution 269 paragraphs 21 and 22 require banks to estimate at each reporting date provisions (reserves) for a financial asset and contingent liabilities. This amount is reflected by banks in the accounting and financial reporting no later than the last working day of each month.</p> <p>Factoring off balance- sheet commitments into provisioning is a key decision point which should incorporate banks' expectations of drawdowns on that loan commitment, within 12 months or over expected life of the loan commitment, depending on the staging process (IFRS 9 B5.5.30 and B.5.5.31).</p> <p>ARDFM assesses that contingent liabilities are included in the system for classification and provisioning based on historical data on drawdown of loan commitment. Off balance sheet items are also included in the "regular AQR."</p>
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>As part of the assessment of the risk management system, ARDFM conducts inspection to assess the bank's methodology for calculating provisions to ascertain compliance with IFRS and supervisory requirements, including reasonable and adequate reserves for assets and mathematical models used to determine the provisioning rates for portfolios of loans subject to collective provisioning and the degree of its automation.</p> <p>The methodology for calculating (provisions) reserves</p> <p>Pursuant to Resolution n. 269 par. 3 and 4, reserves are created in accordance with IFRS 9 and based on the methodology for calculating provisioning agreed with the Supervisors. The methodology should be approved by the executive body of the bank and should contain (Resolution n. 269 par. 24 and 25):</p> <ol style="list-style-type: none"> 1) a list of units participating in the process of determining the provisions (reserves) with description of their responsibilities and processes of interaction. 2) a list of signs of impairment of a financial asset, including criteria for the materiality. 3) the criteria for assigning financial assets and contingent liabilities to '<i>individual</i>' financial assets and contingent liabilities for which provisioning is calculated on individual base. 4) criteria for grouping financial assets and contingent liabilities by general characteristics of credit risk. 5) a procedure for determining the amount of provisions for homogeneous and individual financial assets/contingent liabilities, with and without collateral, including the procedure for calculating PD, LGD, discounting factor, cash flow, and other element involved in calculation of expected and (or) existing credit losses.

⁵⁹ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	<ol style="list-style-type: none"> 6) the frequency of calculating provisions. 7) criteria for determining a significant increase in credit risk (SICR). 8) definition of default (DoD) and the procedure for determining the risk of default. 9) the procedure for analyzing the range of possible scenarios of expected credit losses (ECL). 10) the procedure for determining the period during which the ECL is estimated. 11) the definition of '<i>significant financial difficulties</i>' of the counterparty. 12) sources of statistical and macroeconomic information used in estimating credit losses and the procedure for collecting them. 13) the procedure for collecting statistical information used in calculation of provisions. <p>Changes to the methodology are admissible only for predefined reasons (for example, inconsistency with IFRS standards, test results, change in the source of statistical and macroeconomic data, change in the homogeneous financial assets, and improvement in the accuracy of calculation). Within five working days from its approval, the methodology should be submitted to the Agency, which should notify its comments within sixty working days. ARDFM can also notify banks with comments on the methodology during monitoring and supervision of banking activities; findings must be addressed within 30 working days from the notification.</p> <p>Moreover Resolution n. 188/2019 par. 21 n. 7) requires the board of directors to ensure availability of a reliable methodology for the formation of provisions. To ensure the sufficiency of provisions, the bank annually (or more often if necessary) shall conduct analysis of its methodology by determining the compliance of provisions calculated in accordance with the methodology with the actual amounts of losses; analyzing current market conditions and changes in macroeconomic indicators; validating the methodology.</p> <p>Write off</p> <p>Resolution n. 269 does not set timely write off requirements for uncollectable loans. Timely write-off criteria mitigate the risk that NPLs can be carried on the balance sheet for excessive period. IFRS 9 does not set a timeline beyond which an impaired financial instrument should be written off. However, it requires an entity to directly reduce the gross carrying amount of a financial asset when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof (par. B4.5.9). Further, IFRS 7 requires disclosure of write-off criteria. Timely write-offs of uncollectible loans increase transparency and comparability of NPL ratio and coverage ratio; it strengthens banks' balance sheets. The Agency challenges the methodology for calculating provisioning during on-site inspections.</p>
EC5	<p>The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to</p>

	<p>identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).</p>
<p>Description and findings re EC5</p>	<p>According to Res. n. 269 par. 1 n. 3) and 5), financial assets and contingent liabilities are classified into:</p> <ul style="list-style-type: none"> • “individual:” a financial asset whose gross book value at the reporting date exceeds 0.2 percent of equity according to the financial statements, but not less than KZT fifty million, or a financial asset which is debt of a related party. Provisions are calculated separately for each individual financial asset. • “homogeneous:” a group of financial assets with similar credit risk characteristics, based on the methodology. For them, provisions are calculated in accordance with the methodology (collectively) When forming collective provisions for homogenous loans, the bank shall carry out the analysis of historical data covering the required period of time, supplemented by the current market and economic situation (Res. 188/2019 par. 21 n.5). <p>ARDFM pointed out that Regulation № 269 establishes the following minimum number of days of overdue loans for further classification:</p> <ul style="list-style-type: none"> • more than 30 calendar days trigger SICR on both homogeneous and individual assets. • overdue indebtedness for the period over 60 (sixty) calendar days is a trigger of impairment for individually significant financial assets. • overdue indebtedness for a period over 90 (sixty) calendar days is a trigger of default. <p>Provisioning requirements follow IFRS9 staging process, with focus on: (i) 12 months ECL for financial assets and contingent liabilities for which there has not been at the reporting date a SICR since initial recognition (Stage 1); lifetime ECL for financial assets and contingent liabilities exhibiting SICR since initial recognition (Stage 2). Stage 3 are credit impaired loans.</p> <p>Significant Increase of Credit Risk (SICR)—Stage 2 Loans</p> <p>Criteria for SICR are established by the bank’s methodology and should consider significant changes in external market credit risk indicators, actual or expected reduction in internal or external credit rating (based on reasonable and confirmed information), or scoring; significant changes in the value of the collateral or quality of guarantees, other signs of SICR in accordance with IFRS 9 and provided by the bank’s methodology.</p> <p>In accordance with IFRS9 par. 5.5.11, there is a presumption that credit risk has increased significantly since initial recognition when contractual payments are more than 30 days past due. Nonetheless, Resolution n. 269 par. 10 does not spell out several important criteria mentioned by IFRS9 B5.5.17 is assessing change in credit risk (for example, adverse change in business that can cause a significant change in the borrower’s ability to meet its debt obligations; significant change in the operating results; adverse change in the regulatory, economic, or technological environment of the borrower; covenant waivers or amendments), but leave to the methodology the concerned choice.</p>

Credit Impaired—Stage 3 Loans

The below table compares IFRS9 definition with Res. 269 and shows that there are (i) area of full overlap (let a and d); (ii) cases where the definition is similar (let c); and a final clause which recall *'the other events stipulated by IFRS 9 and established by the Methodology for calculating provisions (reserves)'*.

IFRS9 Definition of credit impaired loans	KZ Definition of objective evidence of impairment
(a) significant financial difficulty of the issuer or the borrower	1) availability of reasonable and confirmed information about significant financial difficulties of the counterparty;
(b) breach of contract, such as a default or past due event;	2) presence of overdue indebtedness of the counterparty on the principal debt and (or) remuneration for a period exceeding sixty calendar days;
(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;	3) loan restructuring due to financial difficulties of the counterparty one or more times in the last twelve months;
(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganization;	4) the financial organization has reasonable and confirmed information about force majeure and (or) other circumstances that caused the counterparty substantial material damage, determined according to the Methodology for calculating provisions (reserves), and (or) do not allow it to continue its activities, including information on deprivation or suspension of a license to conduct banking and other operations, as well as information on the absence of employment or entrepreneurial activity of the counterparty;
(e) the disappearance of an active market for that financial asset because of financial difficulties;	5) reasonable and confirmed information about the high probability of bankruptcy, reorganization of the counterparty on the basis of reasonable and confirmed information and (or) involvement in the court proceedings of the counterparty, which may deteriorate its financial condition;
(f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.	(6) the death of the counterparty;
	7) other events stipulated by IFRS 9 and established by the Methodology for calculating provisions (reserves).

The assessors noted that the Agency in its official documents refers to **non-performing loans as those with 90 days overdue** (for example, Annual Report 2020 and 2021). However, according to BCBS Guidelines *Prudential treatment of Problem Assets* (par. 24), the definition of non-performing assets is broader, as it should include also:

	<ul style="list-style-type: none"> • 'all exposures that are credit-impaired (. . .) according to the applicable accounting framework' as well as • all exposures which are not defaulter or impaired, but nevertheless <i>'where there is evidence that full repayment based on the contractual terms, original or, when applicable, modified (e.g., repayment of principal and interest) is unlikely without the bank's realization of collateral, whether or not the exposure is current and regardless of the number of days the exposure is past due'</i>. <p>In substance, NPL recognition is limited to 90 days past due exposures (around 3 per cent of loans), while it should incorporate also IFRS9 stage 3 loans (about 15 percent, according to 2022 AQR), as well as foreclosed assets (as these exposures are unlikely to be repaid without the realization of the collateral).</p> <p>AQR results include assets on the balance sheet of subsidiaries created by the banks for purchasing their distressed assets (AMCs), i.e., 14.8 percent of stage 3 loans includes credit impaired assets on the balance-sheets of AMCs.</p> <p>Moreover, banks reduced NPL by selling them to subsidiaries crated for purchasing distressed assets from the parent companies; as these transactions are exempted from related party requirements, NPL have been sold at their nominal value instead of the market value. This has been considered under CP20.</p>
EC6	<p>The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.</p>
Description and findings re EC6	<p>In the context of the assessment of the risk management system, ARDFM monitors the quality of banks' loan portfolios during off-site supervision. Moreover, banks provide monthly reporting on loans and contingent liabilities according to the requirements of Regulation № 313.</p> <p>The assessors went through on-site inspection report found the Agency has access or information concerning the classification of assets and provisioning.</p>
EC7	<p>The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.</p>
Description and findings re EC7	<p>The Agency can exert motivated judgment on the adequacy of banks reserves. According to Res. 2019/189 par 24 a motivated judgment on assessment of the adequacy of provisions (reserves) of a bank is a justified professional opinion of the collegial body on the compliance of the formed reserves with the international standards of financial reporting, methodologies on formation of provisions, including the compliance of methodologies by their formation of the risks, and on the reliability of information, used for their formation.</p> <p>ARDFM pointed out that as part of the inspection, the supervisor checks the correctness of the calculation of reserves on assets and contingent liabilities, identifies violations, and assesses the level of risk. ARDFM has the power to require</p>

	<p>the bank to increase its levels of provisioning, including by using motivated judgment.</p> <p>The assessors examined a sample of on-site inspection reports and found that ARDFM required banks to increase provisioning.</p>
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	<p>Res. n. 269 par. 17 states that when calculating ECL banks consider information on the sale of collateral for a period of at least two years. Absent this information, banks apply the following haircut (called 'liquidity ratios'):</p> <ol style="list-style-type: none"> 1) residential and (or) commercial real estate, including land plots - 0.7; 2) vehicles - 0.5; 3) equipment, goods and materials, products ready for sale - 0.4; 4) guarantees of individuals and (or) legal entities, with the exception of guarantees, issued by banks with Standard & Poor's or similar Agency's rating not lower than the sovereign rating of the Republic of Kazakhstan, or released by a subject of the quasi-public sector - 0; 5) property, including in the form of money coming in the future, - 0; 6) highly liquid securities - 0.95; 7) guarantees issued by bank; a legal entity with a rating not lower than the sovereign rating of the Republic of Kazakhstan by the Standard & Poor's rating agency or a similar level rating by one of other rating agencies; by a subject of the quasi-public sector - 1; 8) security in the form of money – 1. <p>For other types of security for which there is no confirmed information on the sale of collateral for a period of not less than two years, it is allowed to use a liquidity ratio to the value of security provided by the Methodology for calculating provisions (reserves), but not more than 0.7. For types of security not provided by the Methodology, the liquidity ratio equal to zero is applied.</p>
EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <ol style="list-style-type: none"> (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	As stated under EC1, the board of directors should approve the policy on problem assets . The policy should contain the identification of problem assets ; methods of

	<p>managing (restructuring, sale, write-off, withdrawal of collateral, bankruptcy, and others) and terms of implementation; limits and quali/quantitative parameters of early response to the risk of increasing the volume of problem assets; a list of divisions and the internal procedure for their interaction when working with problem assets; procedures for reporting to the board of directors; procedures for assessing the methods used by the bank to manage problem assets (Resolution n. 188/2019 par. 21 n. 6).</p> <p>Reclassified of loan as performing</p> <p>This process is related to restructuring activities. Regulation is deficient since it does not require a minimum ‘cure period’ for exiting the status on non-performing and it legitimates ‘evergreening’ by providing new loan to pay overdue debt on a loan either from the same bank or from other financial institutions.</p> <p>Restructured Loans</p> <p>Res. 188/2019 par 42, n. 2) states that banks’ credit policy should provide for the internal procedure for making credit decisions regarding the restructuring of loans due to financial difficulties of the borrower which should be based on the principles of reasonableness, expediency, and independence.</p> <p>Restructured loans include:</p> <ul style="list-style-type: none"> • changes to the schedule of payments, including provision or extension of a grace period for the principal and (or) interest. • extension of the loan term. • deferral of one or more payments for a period of more than 30 calendar days; forgiveness of part of the principal debt and (or) interest. • capitalization of remuneration payments overdue in aggregate for more than 30 (thirty) calendar days. • change (conversion) of the currency with capitalization of overdue interest debt and (or) fixing the exchange rate for loans in foreign currency. • provision of a new loan to pay overdue debt on a loan from a bank, including other financial institutions. • increase in the credit limit in the event that there is an aggregate overdue of more than 30 (thirty) calendar days of debt on a loan. • reduction of the interest rate, <i>except for a change in the size of the base indicator for a loan with a floating interest rate.</i> • reduction of debt as a result of repayment at the expense of the borrower's pledged property transferred to the financial organization. <p>Res. 269/2019 distinguishes restructured loans in two categories:</p> <p>a) those motivated by financial difficulties of the borrower (<i>‘any change in the procedure and terms of the loan contract in order to resolve the existing or expected difficulties of the borrower (co-borrower) in servicing the loan’</i>; art 2 n. 11). The definition covers the same as above-mentioned cases as Res. 188/2019, but it also adds that restructuring one or more time in the last twelve months is ‘</p>
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	<p><i>objective evidence of impairment</i>¹ (par. 16 n. 3), triggering an evaluation for a potential transition to stage 3 loans.</p> <p>b) restructured loans due to deterioration of the borrower's financial condition, which is an element to be considered in the definition of <i>default</i> (art. 1 n. 4).</p> <p>In substance the category under let b) is a <i>forced restructuring</i>.</p> <p>Res. 269, par. 14 states that a credit-impaired financial asset (stage 3) is transferred to the category of financial assets with SICR (stage 2), provided that the counterparty has repaid the debt for a period of not less than 12 months which leads to a decrease in the gross carrying amount of a financial asset on the date of formation of provisions (reserves) to the level equal to or below the amount of debt at the point of transfer of a financial asset in the category of credit-impaired, and in case of absence, on the date of the valuation, of objective evidence of impairment based on the criteria established by the Methodology of calculating provisions (reserves). The minimum cure period of 1 months, present in the Russian version of the Circular but not in the English translation, is compliant with the minimum cure period envisaged BCBS Guidelines <i>Prudential treatment of Problem Assets</i> (par. 31).</p> <p>Moreover, a financial asset having signs of SICR (stage 2) enters the category of financial assets, provisions (reserves) for which are formed in an amount equal to twelve-month ECL (stage 1), subject to repayment by the counterparty of the debt, which leads to a decrease in the gross carrying amount of the financial asset at the date of formation of provisions (reserves) to a level equal to or lower than the amount of debt at the time of transition to the category of financial assets with SICR and absence at the date of formation of provisions (reserves) of a SICR.</p>
EC10	<p>The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.</p>
Description and findings re EC10	<p>Pursuant to Resolution 188/2019 par. 41, the system for classifying assets by the level of credit risk shall provide the information for the board of directors, committees under the board of directors, the management board, and other divisions of the bank involved in the credit risk management process and allow to assess the level of credit risk of the bank both in terms of the balance sheet as a whole and in the context of each asset. See also CP 15, EC7.</p> <p>ARDFM assesses that the Board obtains timely and appropriate information on the condition of the bank's asset portfolio by checking reports and communications from the risk management unit and the Head of Risk Management with respect to credit risk.</p>
EC11	<p>The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.</p>

Description and findings re EC11	As stated under EC 5, provision for ‘individual’ financial assets – those exceeding 0.2 percent of equity and KZT fifty million - are calculated separately . The same rule applies to financial assets, which is the debt of a related party . Moreover, Resolution n. 188/2019 par. 42 n. 7) requires banks to form provision on individual basis for loans that, based on the indicators provided by the methodology on problem assets, exhibit a SICR .
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks’ problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	The Agency was not able to provide granular data on the concentration of Stage 3 loans per economic sector.
Assessment of Principle 18	Materially Non-Compliant
Comments	The prudential framework on problem assets is not fully aligned with international standards: <ul style="list-style-type: none"> • NPL recognition is limited to 90 days past due exposures (around 3 per cent of loans), but it does not include IFRS9 stage 3 loans (about 15 percent, according to 2022 AQR), nor ‘unlikely to pay’ (UTP) exposures (namely, foreclosed assets). • Resolution n. 269 does not set timely write-off requirements for uncollectable loans. Recommendation: <ul style="list-style-type: none"> • NPL recognition criteria should include IFRS9 stage 3 loans, as well as foreclosed assets. • Timely write off requirements could be considered.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁶⁰
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration

⁶⁰ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

	risk. ⁶¹ Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	<p>Regulations require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. According to Res. 188/2019:</p> <ul style="list-style-type: none"> • effective levels of <u>risk appetite</u> shall consider all significant concentration risks (in the client, on currency, on country risk, on market segments and other types of concentration; par. 16 n. 3) • banks shall identify all significant risks inherent to their activities (including risks on balance sheet and off-balance sheet transactions, by groups, portfolios and certain types of activities of business units). The board of directors, the risk management committee and the head of risk management shall regularly assess the risks inherent to the bank's activities. The <u>risk assessment procedure</u> includes a continuous analysis of current risks, as well as identification of new and potential risks. When assessing risks, the bank shall consider the degree of concentration of significant risks (par. 36). <p>Moreover, Resolution № 170 requires banks to carry out lending activities and credit risk management within the framework of the approved <u>credit policy</u>, which includes, inter alia, the internal procedure for making credit decisions, including the procedure for consideration and approval of loans, including with respect to lending to persons related to the bank by special relations and lending limits to limit the concentration of credit risk.</p>
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure ⁶² to single counterparties or groups of connected counterparties.
Description and findings re EC2	<p>The bank shall develop forms of <u>management reporting</u> which includes on the concentration of credit risk of the largest borrowers (counterparties) and borrowers (counterparties) related to the bank by special relations, including with the bank's shareholders and the dynamics of its change (Res. n. 188/2019, par. 42, n. 11).</p> <p>As part of the annual SREP, the supervisory authority verifies that adequate systems, IT infrastructures and procedures are in place to provide the board and management board with appropriate, reliable, timely and complete information to identify and monitor risks.</p>

⁶¹ This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

⁶² The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e. it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see "*Measuring and controlling large credit exposures*", January 1991).

EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	<p>The Agency's representatives prepare monthly managerial reporting which includes concentration risk (the assessors examined the last 2 for the 2 D-SIB). Moreover, the assessor requested information of the banking system exposure to top 30 borrowers and found that this is relatively low (11.5% of total loans).</p> <p>During on-site inspections, the Agency assesses the bank's risk management policies and procedures for establishing thresholds for acceptable concentrations of risk.</p>
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	<p>The Agency receives information from banks, which enables it to analyze portfolio concentration, including industry, geographic and currency risks within the framework of the approved regulatory reporting, which is submitted by banks monthly:</p> <ul style="list-style-type: none"> • information on loans and contingent liabilities (credit register, Regulation № 313). • information on compliance with prudential norms, including loan concentration norms (Regulation №75). <p>In addition, the Agency representatives have the right to interact with the Board of Directors / Board / staff of the bank and obtain the necessary information in the exercise of control and supervisory functions. ARDFM has the right to: (i) receive all necessary information relating to the activities of the bank; (ii) request verbal and written information and documents, including materials of meetings (including those held in absentia) of collegial bodies on a monthly and quarterly basis; be present as an observer at the meetings of the Management Board, the Board of Directors, permanent or temporary commissions (committees, working groups) of the organization. As a result, the Agency emphasized that it monitors, among other things, the concentration of industry, geographic and currency risks in the bank's portfolio.</p> <p>Based on the information provided to the assessors, there is geographic concentration of loans (46 percent in Almaty). As regards economic sectors, banks portfolios are relatively diversified: major exposures are towards industry (11.5 percent) and trade (10 percent); however, the bulk of exposures (loans to individual, 52 percent) have not been attributed to any sector. The portfolio in currency is about 10 percent of total loans.</p>
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case-by-case basis.

Description and findings re EC5	<p>Banking Law does not define a "group of connected counterparties". ARDFM can exert its motivated judgment to determine that a borrower is a related party of the bank (see CP 20, EC 1), but it encounters limitations to its discretion in applying the definition of 'group of connected counterparties' on a case-by-case basis.</p> <p>Resolution n. 170 states that the term "<i>one borrower</i>" is understood as each natural or legal person against which the bank has or has arisen the claims. The amount of risk for a <u>group of two or more borrowers</u> is calculated in aggregate as per one borrower, if the amount of risk of each of the borrowers exceeds 0.1 percent of the bank's equity capital, as well as if one of the following circumstances exists:</p> <ol style="list-style-type: none"> 1) one of the borrowers is a major participant, affiliated person, close relative (parent, child, adoptive parent, adopted, full and half brother or sister, grandparent, grandchild), spouse, close relative of spouse, first manager of other borrower, or person interested in transaction of other borrower 2) a major participant, a close relative, a spouse, a close relative of a spouse, or a person interested in the transaction by one borrower, or a person interested in the transaction by another borrower, is a large participant, a close relative, a spouse, a close relative of a spouse, or a first manager of another borrower, or a person interested in the transaction by another borrower 3) a major participant, a close relative, a spouse (wife), a close relative of a spouse or a chief executive of one borrower or a person interested in making a transaction with one borrower is a major participant, a close relative, a spouse, a close relative of a spouse (spouse) or the chief executive officer or a person interested in the transaction, a major participant, close relative, spouse (wife), close relative of the spouse (wife) or the chief executive officer of another borrower or a person interested in the transaction by another borrower; 4) there are sufficient grounds confirming that one of the borrowers transferred to another for use the money received by him from the bank as a loan in an amount exceeding the own capital of the transferring borrower 5) there are sufficient grounds confirming that the borrowers jointly or separately transferred the funds received from the bank as a loan in an amount exceeding the total equity capital of these borrowers for use by the same third party that is not a borrower of the bank 6) the borrowers are related in such a way that one of the borrowers (except for banks of the Republic of Kazakhstan) bears joint and several or subsidiary liability in the amount exceeding 10 (ten) percent of its assets for the obligations of the other borrower 7) an official of one borrower has a financial interest in the activities of other borrowers of the bank 8) borrowers are interconnected by a joint activity agreement or other document that contains signs of a joint activity agreement, with the exception of borrowers who are members of a consortium 9) borrowers are related in such a way that their obligations are secured by common collateral and (or) guarantee and (or) surety of the same third party, the total value of which covers more than 35 (thirty-five) percent of the book value of the loan, unless there are general collateral provided in the form of insurance policies, standby letters
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	<p>of credit, guarantees, as well as guarantees of the DAMU Entrepreneurship Development Fund joint-stock company, Samruk-Kazyna National Welfare Fund joint-stock company, Baiterek National Management Holding joint-stock company and their subsidiaries, joint-stock company Fund for Problem Loans, institutions for the development and support of entrepreneurship of the Republic of Kazakhstan, a national company that performs export support functions, international financial organizations, financial institutions, non-resident banks of the Republic of Kazakhstan with a rating of at least "B" from the S&P or equivalent rating from one of the other rating agencies;</p> <p>10) the borrowers are related in such a way that one of the borrowers has provided collateral, a guarantee, a guarantee to secure the obligations of another borrower, except for cases where there is security provided in the form of insurance policies, standby letters of credit, guarantees, as well as guarantees mentioned under n. 9</p> <p>11) borrowers:</p> <p>are legal entities registered in the territory of: Principality of Andorra, Principality of Liechtenstein, Republic of Liberia, Principality of Monaco, Marshall Islands (Republic of the Marshall Islands), or their citizens, or</p> <p>are legal entities registered in the territory of states included by the Organization for Economic Cooperation and Development in the list of offshore territories that have not accepted obligations for information exchange, or their citizens, or</p> <p>have major participants, affiliates, close relatives, chief executives or persons interested in transactions with these borrowers, registered or citizens of the states specified in paragraphs two and three of this subparagraph.</p> <p>12) borrowers are related to each other on other grounds provided for by the Banking Law</p> <p>13) borrowers are participants in a real estate construction project, including a customer of a real estate construction project, equity participants in the construction of an object under construction and guarantors of equity participants.</p> <p>The above conditions constrain the supervisory judgments and do not appear to be aligned to the concept of '<i>economic independency</i>' of the Basel Framework ('<i>if one of the counterparties were to experience financial problems, in particular funding or repayment difficulties, the other(s), as a result, would also be likely to encounter funding or repayment difficulties</i>'; par. 10.10). It could be useful to introduce a general clause ('<i>where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities</i>') to provide the supervisor with the needed discretion in applying this definition of "group of connected counterparties" on a case-by-case basis.</p>
EC6	<p>Laws, regulations or the supervisor set prudent and appropriate⁶³ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior</p>

⁶³ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	<p>Prudential standards include the '<i>maximum exposure to single borrower</i>' both for banks and banking groups (Banking Law Art. 42).</p> <p>Resolution №170 par. 52-57 establishes the following set of limits:</p> <ul style="list-style-type: none"> • exposures to borrowers who are not related parties must be kept below 25 percent of <u>total capital</u> (k3- 0.25) • the aggregate amount of large exposure (those exceeding 10% of the bank's equity capital) must be kept below 5-time bank's equity. • exposure the Development Bank of Kazakhstan should not exceed 5 percent of banks total capital. • the aggregate amount of securitized loans transferred to a special financial company of the Stress Assets Fund shall not exceed the amount of the bank's capital. <p>It would be appropriate to calibrate the prudential limits to Tier 1, instead of the total capital (Basel framework, par. 10.8)</p> <p>Resolution n. 170 par. 57 adopts a broad concept of the term 'exposure' (claim) which includes also contingent liabilities, as well as counterpart credit risk (for example, from derivative). Resolution n. 170 par. 58 exclude sovereign exposure and claim to the subsidiary.</p> <p>ARDFM assesses that senior management monitors them through the managerial report provided to the Agency representative, which includes pre-limit alerts.</p>
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	Stress test requirement includes all significant risks to which the bank is potentially exposed as well as the relationship among various types of risks (see CP 15, EC13).
Additional criteria	
AC1	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following:</p> <p>(a) ten per cent or more of a bank's capital is defined as a large exposure; and</p> <p>(b) twenty-five per cent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.</p> <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	
Assessment of Principle 19	Largely Compliant
Comments	Regulations require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. The

	<p>Agency assesses concentration risk through supervisory reporting, SREP and on-site inspections. Almost two thirds of the portfolio is composed of consumer lending and the top 30 borrowers account for 11.5 percent of total loans. The definition of ‘group of connected counterparties’ is broad, but quite prescriptive (Resolution n. 170 par. 54); it could be useful to introduce a general clause (<i>‘where it is likely that the financial problems of one counterparty would cause difficulties for the other counterparties in terms of full and timely repayment of liabilities’</i>) to provide the supervisor with the needed discretion in applying this definition on a case-by-case basis and simultaneously expand the areas of ‘motivated judgement’ to concentration risk. Prudential limits are calibrated to total capital instead of Tier 1.</p> <p>Recommendations:</p> <ul style="list-style-type: none"> • calibrate large exposure limits to Tier 1, instead of total capital. • Expand the ‘motivated judgement’ to the <i>“group of connected counterparties”</i> to provide the supervisor with the needed discretion in applying this definition on a case-by-case basis.
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties ⁶⁴ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties ⁶⁵ on an arm’s length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of “related parties”. This considers the parties identified in the footnote to the principle. The supervisor may exercise discretion in applying this definition on a case-by-case basis.
Description and findings re EC1	<p>The definition of related-party transactions is broad enough to capture the parties identified in the footnote to this principle.</p> <p>Pursuant to the Banking Law art. 40 par. 3, the following persons are recognized as persons related to the bank by special relations:</p> <p>1) an official or <u>executive employee</u>, heads and permanent members of the committees of the board of directors and the relevant body of the bank, whose powers include making decisions on the alienation of assets, change or termination of the collateral (except for the cases of repayment by the debtor of obligations secured by the collateral or enforcement by the bank of the collateral), decisions on the issuance of loans and guarantees above limit established by the supervisor (0.7 percent of the bank's capital—for banks with own capital of up to 100 billion</p>

⁶⁴ Related parties can include, among other things, the bank’s subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank’s major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁶⁵ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

tenge; 0.5 percent of the bank's capital for banks with capital exceeding 100 billion tenge) as well as their spouses and close relatives.

2) an individual or a legal entity, who is a major participant of the bank, or an official of a major participant of the bank, as well as their spouses and close relatives.

3) a legal entity in which the persons, specified in subparagraphs 1) and 2) own ten or more percent of the shares (excluding the preferred and redeemed shares) or participation stakes in the authorized capital or are officials.

4) affiliated persons of the bank (the definition if provided by the Joint Company Act, art. 64).

5) an individual or legal entity corresponding to the characteristics of connection with the bank by special relations, established by the regulatory legal act of the authorized body.

5-1) borrower (physical or legal entity) belonging to a group of borrowers of the bank, united in such a group in accordance with the requirements of the maximum risk per borrower, in which one of the borrowers of such a group is a related party.

5-2) Borrower (physical or legal entity) with which a bank carried out a transaction in violation of its internal procedures in terms of compliance with the requirements for assessing creditworthiness and (or) securing such a transaction.

5-3) Physical or legal entity that has entered a transaction with a bank, in which a related party to the bank provides collateral, excluding guarantees (sureties), bank reserve acceptances with a debt rating of "BBB" or higher from Standard & Poor's or a similar level of rating from Moody's Investors Service and Fitch.

The requirements of sub-paragraphs 5-1) and 5-2) apply in cases where the size of the bank's transaction is:

- 2 or more percent of the bank's capital (as of the date of decision making)—for banks with capital up to 100 billion tenge.
- 1 or more percent of the bank's capital (as of the date of decision making)—for banks with capital above 100 billion tenge.

Motivated judgement on related party

The supervisor may exercise discretion in applying the definition of related party on a case-by-case basis. ARDFM has the **right to classify an individual or a legal entity as a related party by using a motivated judgment**. In this case, the individual or the legal entity is recognized by the bank as a related party from the date of receipt of the supervisory response measures by the Agency.

According to Res. 189 par. 16, a **motivated judgment on recognition of a person as a bank's related party** is a justified professional opinion of a collegial body about the presence of signs of connection in cases where:

1) a bank, a major participant of a bank, a participant of a banking group has control over a legal entity in accordance with international financial reporting standards.

2) cash flows and (or) the main liabilities of an individual or legal entity arose as a result of a transaction with a bank and (or) a bank's related party, which will lead to a deterioration in the financial position of the bank.

	<p>3) the purpose of obtaining a bank loan and (or) its use does not correspond to the nature of economic activity and (or) the needs of the borrower—based on his/her entrepreneurial or labor activity and (or) the business plan.</p> <p>4) lack of information on the ownership structure of the borrower—a legal entity does not provide an opportunity to identify all ultimate beneficiaries and (or) all participants owning more than 10 (ten) percent of voting shares in the authorized capital of the borrower—legal entity.</p> <p>5) the expected cash flows of an individual or legal entity, considering collateral, are not sufficient to repay liabilities on a bank loan as of the date of the decision to issue it (unless the bank takes measures to improve the quality of the assets of the bank).</p> <p>6) an individual or legal entity was accepted with a significant violation of the bank's requirements for transactions to be concluded provided by the internal documents of the bank, and leads or led to significant risks for the bank.</p> <p>7) the conditions of the loan imply restrictions to the liability of the borrower for the fulfillment of the terms of the loan agreement that do not correspond to the customs of business turnover, providing for events the occurrence of which stops completely or in part of the obligations of the borrower and lead or led to significant risks for the bank.</p> <p>8) the conditions of a bank's transaction with an individual or legal entity meet the criteria for recognizing transactions with preferential terms provided for Banking Law Art. 40 par. 2.</p> <p>The cases provided for under 1), 2), 3), 5), 6) and 7) are considered by the supervisor if the size of the transaction is:</p> <ul style="list-style-type: none"> • more than 2 percent of the bank's equity capital as of the date of the decision—for banks with equity capital up to 100,000,000,000 (one hundred billion) tenge inclusive. • more than 1 percent of the bank's equity capital as of the date of the decision—for banks with equity capital exceeding 100,000,000,000 (one hundred billion) tenge. <p>However, the size becomes not relevant in cases of several transactions carried out with the scope to circumvent the threshold.</p> <p>When forming the motivated judgment on recognition of a bank's related party, in the case provided for by subclause n. 1, the Agency shall consider the opinion of an independent expert, including the one hired by the bank.</p> <p>The assessor examined one motivated judgement on related parties and found that the Agency, following a disagreement with the bank, brought to the attention of the Supervisory Committee a draft decision instructing the bank to recognize a counterpart as a related party. The Committee approved the proposal.</p>
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest

	rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁶⁶
Description and findings re EC2	<p>Banks are prohibited from granting preferential terms to related party (B.L. 2444 art 41 par. 1). According to BL art. 40 par. 2, granting preferential terms means making a transaction with a related party, or in its interests, which by its nature, purpose, features and risk, the bank would not make with a no related party, namely:</p> <ol style="list-style-type: none"> 1) charging remuneration and fees for performing banking operations which are lower than under the terms offered to third parties. 2) payment of remuneration on deposits and other funds collected from a related party higher than under the terms offered to third parties. 3) acceptance of pledges, guarantees, sureties or other means of ensuring the performance of obligations in an amount lower than required for similar transactions with third parties. 4) deferral for charging remuneration, repayment of the principal debt and (or) other payments for banking operations more than for similar operations with third parties. 5) payment for the acquired property and (or) services at a price higher than the payment of similar property and (or) services to third parties on transactions exceeding 0.1 percent of the bank equity capital. 6) sale of property to a related party at a value lower than the sale of similar property to third parties or below the market value. 7) sale of securities to a related party at a value lower than the sale of similar securities to third parties or below the market value. 8) transactions considered as made with preferential conditions by the Agency using its "motivated judgment." <p>In addition:</p> <ul style="list-style-type: none"> • banks are required to carry out lending activities in accordance with the internal policies regulating the performance of operations. This includes an internal procedure for reviewing, approving, and making decisions on granting (or refusing to grant) a loan, including with regard to lending to a related party (Res. n. 188, par. 42 sub-3). • the code of corporate governance approved by the general meeting of shareholders includes a procedure to manage the conflict of interest, as well as controls over its implementation (CP 14, EC5)
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	Banking Law art. 40 par. 5 states that a transaction with a related party may be made only by the decision of the board of directors , except for the cases when

⁶⁶ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g. staff receiving credit at favorable rates).

	<p>the standard terms are approved by the board of directors and applied to similar transactions with third parties.</p> <p>Banks are also prohibited to grant loans to their members of board of directors and major participants, with exception of bank loans and financing, stipulated by B.L. Article 52-5, par. 1, sub. 4) and 5) (which are two Islamic finance products), not exceeding 0.02 percent of the bank equity capital at the date of the bank decision to grant the loan or financing. The prohibition <u>does not extend to the board of directors' business interests</u>.</p> <p>The related party shall not participate in the debate and decision-making of any transaction between the bank and: him/her; any of his/her close relatives or spouse; any legal entity in which he/she or any of his/her close relatives, his or her spouse is an official (except for an independent director) or a major participant. The decision of the board of directors on any transaction with a related party may be taken only after consideration of all its terms by the board of directors.</p> <p>In view of the material deficiencies that emerged in relation to transactions with related parties, the regulatory framework could enhance the function of the Audit Committee and/or independent directors. They could play a more active role in monitoring these transactions, for example by designing board approval procedures, conducting investigations and having the possibility of obtaining advice from independent experts. Independent board members can also play an evaluation, support and proposal role in the organization and performance of internal controls over related party transactions. For related parties' transactions exceeding certain thresholds, the regulation could even require the independent directors' (and/or the Audit Committee) motivated opinion (binding or not binding) on the bank's interest in entering these transactions, as well as on the convenience and substantial correctness of its underlying terms.</p> <p>Pursuant to B.L. Art. 40 par. 4, a bank cannot make a transaction with any person, the value of which exceeds the amount, established by the regulatory legal act of the authorized body, and which entails:</p> <ul style="list-style-type: none"> • payment of obligations to the bank's related party. • purchase of any property from a person connected with the bank's related party. • acquisition of securities issued by a bank's related party, except for the securities owned by the bank. <p>As regard write-off, Banking Law art. 40 par. 5 states that the waiver of the rights of claims in respect of assets granted (placed) to a related party are carried out with the subsequent notification of the general meeting of shareholders, except for subsidiaries of the bank acquiring dubious and hopeless assets of the parent bank.</p> <p>Notification to the general meeting of shareholder is a procedural safeguard which comes in addition to the board approval; however, the exception for transactions on distressed assets sold by the parent company to its subsidiary is emblematic on the lack of transparency. This exception should be read in conjunction with par. 8 of art 40 which exempts these transactions from the requirements of paragraphs 1, 2, and 4 of art. 4: prohibition of preferential terms, collateralization, and transactions connected to related parties' transactions.</p>
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	<p>There are 18 asset management companies (AMC) specialized in purchasing dubious and hopeless assets of the parent bank. While currently they hold only 3 percent of NPL, in the past they have been used to cleaning up banks' balance sheet through acquisition of dubious assets at preferential terms. The Agency staff explained that banks grant a loan to the AMC to fund its acquisition of dubious and hopeless assets; then, banks replace in its financial statements the distressed asset with the loan towards the AMC. According to the information provided, in some cases this loan is classified and reported to the central credit registry as "stage 3" assets (since its performance depends upon the underline debt collections), but in other cases it is classified as "stage 1" assets (for example, when it is used to purchase the collateral under auction).</p>
EC4	<p>The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.</p>
Description and findings re EC4	<p>During on-site inspections, ARDFM determines that banks have policies and processes in place to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.</p> <p>One indicator of the Risk Assessment (which feeds into the SREP) is related party exposures to capital (C.3). Such ratio on average is very low (2.2 percent, as at 1.1.23). However, the Authority pointed out that the abuse of related party transactions was a major driver of bank defaults. The assessors went through the on-site inspection reports of 2 banks declared insolvent in 2020 and 2021 and found that the Agency discovered hidden related party lending. This raises concerns about the reliability of the regulatory reporting on related party lending and true extent of the phenomenon.</p>
EC5	<p>Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.</p>
Description and findings re EC5	<p>Limits</p> <p>The prudential framework envisages the below limits to related party transactions:</p> <ul style="list-style-type: none"> banks' exposure to a single borrower who is are a related party should not exceed the limit of 10 percent of total capital (Resolution №170 par. 52-57) the aggregate amount of all bank loans and guarantees to its related entities must not exceed 50 percent of its equity (NBK Resolution n. 80/2012) <p>However, an exception is provided for loans and guarantee to subsidiaries specializing in purchasing doubtful and hopeless loans from the parent company, which can reach 100 percent of banks' equity.</p> <p>Collateralization</p> <p>Banks are prohibited to issue unsecured loans to a related party, except for loans not exceeding the amount established by the regulatory legal act of the authorized body (20 million tenge), as well as loans to the persons who are the members of the banking group. (B.L. art. 41 par 1).</p> <p>Deduction</p>

	There is no power to deduct exposure to related parties from bank's capital.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	The Agency pointed out that it determines that banks have policies and processes to identify individual exposures to and transactions with related parties mainly during on-site inspections. The assessors found evidence of on-site activities; at the same time, the assessors have not been reassured about a systematic check of abusive related party lending through a targeted campaign or a thematic review. Moreover, Res. 188 does not explicitly cover related party transactions among the audit perimeter requirements and the Agency does not receive audits from banks on related party transactions.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	<p>B.L. 2444 1995 art. 40 par. 6 states that banks are obliged to provide NBK with information on related party, as well as on all transactions concluded with these party, in the manner, terms and forms that are provided for by the regulatory legal act of NBK as agreed with the authorized body.</p> <p>The Agency argued that it receives information from banks which allows to analyze information on aggregate risks to related parties, within the framework of the approved regulatory reporting, which is provided on a monthly basis:</p> <ul style="list-style-type: none"> • information on loans and contingent liabilities (credit register, Regulation № 313). • information on compliance with prudential norms, including loan concentration norms (Regulation №75). <p>The assessors requested regulatory reporting and found that the ratio related to party transaction to total capital is relatively low (2.2 percent).</p>
Assessment of Principle 20	Materially non-compliant
Comments	The law provides a broad definition of related party, and the supervisor can exert motivated judgment when recognizing a person as a bank's related party or a transaction as made at preferential terms. There is documented evidence that the risk inherent to related party loans in banks which previously defaulted was higher than officially reported to the supervisor and was the main source of NPLs and reason for liquidation. The assessors went through on-site examination reports related to those banks and found that abusive related party loans led to the extrapolation of private benefits from the banks by insiders. Moreover, the possibility to transfer distressed assets at non-market terms to subsidiaries acquiring dubious and hopeless assets of the parent bank distorts the correct reflection of credit risk and inflates banks' profits. This practice disincentivizes conservative loan origination and underwriting as distressed assets can be transferred without a penalty, often even with a premium. It also delays the creation of a NPL secondary market: there is

	<p>no incentive for banks to sell assets to NPL investors as they will be ready to buy assets only at market price that reflects inherent risks, time value of money, cost of funding, and a profit margin.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Banking Law Art. 40 par. 8 should be revisited and distressed asset transfer by banks to their subsidiaries or organizations specialized in acquiring dubious and hopeless assets should take place at market terms. • The Agency should consider an off-site and on-site thematic review on related party transactions, including with the assistance of external experts, to shed light on the size of the phenomenon and prevent insiders from extrapolating private benefits from banks.
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Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁶⁷ and transfer risk ⁶⁸ in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>As part of the requirements to the banks' risk management system to determine the risk appetite (Resolution 188), the bank's Board of Directors sets the aggregate (aggregated) risk appetite level(s) and risk appetite levels for each type of material risk. The effective risk appetite levels take into account all significant risks of concentration, including concentration on country risk. However, country risk is not explicitly defined in the resolution, and transfer risk is not specifically identified. The authorities should provide greater clarity about both country and transfer risk.</p> <p>In addition, the supervisor does not require firms to establish or report exposures on an individual country basis.</p>
EC2	The supervisor determines that bank' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards

⁶⁷ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporate, banks or governments are covered.

⁶⁸ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)

	and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	Under the Agency Requirements for Internal Controls for AML, banks are required to conduct an assessment of its exposure to money laundering risk and the financing of terrorism under several different risk categories, one of which is on a country or geographic basis. (Chapter 3, par. 13). In addition, Resolution 188 requires the Board of directors to approve a statement of risk appetite, taking into account all significant concentration risks, including at the country level. (Chapter 3, par. 16.3). Nonetheless, the supervisor does not require firms to establish or report risk exposures at the country level.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	The rules of formation of the risk management and internal control system for banks (Resolution 188) establish requirements for information systems. Information systems shall correspond to the complexity of the bank's business, risk profile, areas of activity, volume of assets and role of the bank in the financial system. Information systems shall ensure the operation of risk management system, including the control of compliance with the established limits. However, there are no requirements for information systems to have separate processes to track country risks.
EC4	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	The requirements for country and transfer risks in creating provisions are not regulated by law. However, country risks are taken into account for the purposes of prudential regulation in the risk weighting of assets for capital purposes. Countries with a high rating (at least "AA-") have a zero-weighting factor for credit risk assessment purposes, accordingly, if the rating is downgraded or not, the risk level increases. In addition, there are direct restrictions on investing banks' assets in foreign securities rated below "B," foreign government securities rated below "BBB-."

	Still, these standards set minimum capital requirements and do not address separately provisioning against credit exposures by country or geography.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	The rules of formation of the risk management and internal control system for banks (Resolution 188) establish requirements for the risk appetite of banks. In order to determine the risk appetite, the Board of Directors of the bank sets the aggregated level(s) of risk appetite and levels of risk appetite for each type of significant risk. In addition, one of the requirements for the risk appetite is the consideration of country risks. Nonetheless, the supervisor does not require firms to report exposures on an individual country basis, and the stress testing requirements do not specifically require consideration of country risk.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	The rules of formation of the risk management and internal control system for banks establish requirements for the risk appetite of banks. In order to determine the risk appetite, the Board of Directors of the bank sets the aggregated level(s) of risk appetite and levels of risk appetite for each type of significant risk. In addition, one of the requirements for the risk appetite is the consideration of country risks. The Agency is entitled to request the necessary additional information from the banks as necessary but does not require the regular reporting of country risk.
Assessment of Principle 21	Materially non-compliant
Comments	Laws and regulations do identify country risk as a risk to be considered and do set requirements for monitoring country risk for AML purposes. Supervisors nonetheless do not explicitly require the regular reporting of country risk, nor do they set provisioning requirements for country risk. The Basel Committee has identified country risk as a special exposure worthy of its own core principle and one that requires regular reporting as well as officially set credit provisions. Supervisors should incorporate into national regulations the necessary requirements for gathering and regularly reporting on country risk; setting and applying provisions against credit exposures to certain countries or geographies; and including country risk as a variable for stress testing. The assessment seeks to balance the facts that the ARDFM does identify country risk as a requirement for banks to monitor for AML purposes, but has not yet defined it or transfer risk clearly, articulated requirements for reporting, or requiring specific provisions for higher risk country exposures. The assessors encourage the ARDFM to take these next steps.
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into

	account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	<p>According to NBK Resolution No. 188 par. 43, the board of directors must ensure that the bank has adopted a market risk management system that is appropriate for the “current market situation, development strategy, assets and the level of complexity of the bank’s operations...” The system must provide for the “effective identification, measurement, monitoring and control of the bank’s market risk,” and support the bank’s efforts to develop a market risk hedging strategy to ensure adequate capital to cover the exposure to market risk.</p> <p>With regard to the roles and responsibility, Resolution No. 188 sets out a broad requirement for the bank to establish a “risk culture” that outlines processes, procedures, internal policies for managing risk, including setting out “ethical norms and standards of professional activity of all participants in the organizational structure” (par. 2.25). In terms of specifically the bank’s approach to market risk, the bank is required to define the structure of its market risk management, including determining reporting lines (Par. 44.1), as well as the participants involved, their authority and responsibility, and internal reporting processes (para. 45.2).</p> <p>The Agency evaluates these processes as part of the SREP process. This includes analyzing the allocation of the required level of capital to all significant risks (including market risk) in accordance with the established risk appetite levels, risk assumptions, their limits, desired spread, targets, value-at-risk, approval process, risk appetite, asset classes and interaction with the control system.</p> <p>The qualitative analysis as part of the SREP process examines the qualitative elements of a bank’s market risk management and internal controls. These elements include evaluations of a bank’s exposure to market risk, as well as determining whether the bank’s risk appetite, risk profile, systemic importance, and capital adequacy are appropriate.</p>
EC2	The supervisor determines that bank’ strategies, policies and processes for the management of market risk have been approved by the banks’ Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks’ overall risk management process.
Description and findings re EC2	<p>According to NBK Resolution No. 188 par. 43, the board of directors must ensure that the bank has adopted a market risk management system that is appropriate for the “current market situation, development strategy, assets and the level of complexity of the bank’s operations...” The system must provide for the “effective identification, measurement, monitoring and control of the bank’s market risk,” and support the bank’s efforts to develop a market risk hedging strategy to ensure adequate capital to cover the exposure to market risk.</p> <p>As noted earlier, curators have the ability to receive and review reports sent to the Board of Directors and can observe the Board’s discussions on the bank’s exposures to risks such as market risks. All banks in Kazakhstan have a curator (the largest banks may have a dedicated curator), and supervisors moreover have the same access to firms’ information as curators do.</p>
EC3	The supervisor determines that the bank’s policies and processes establish an appropriate and properly controlled market risk environment including:

	<p>(a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management;</p> <p>(b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff;</p> <p>(c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary;</p> <p>(d) effective controls around the use of models to identify and measure market risk, and set limits, and</p> <p>(e) sound policies and processes for allocation of exposures to the trading book.</p>
Description and findings re EC3	<p>NBK Resolution No. 188 sets out practical expectations for the bank's policies and procedures for controlling market risk exposures.</p> <p>a) effective information systems: The resolution states in Par. 45.9 that the bank must have an "effective management information system" to provide the Board of Directors, the risk management committee, and other relevant divisions within the bank with information on its exposure to market risk. The system is expected to provide information on current market rates, such as interest rates, exchange rates, and other market indicators; updates on significant open positions by currency and financial instrument; the exposure to interest rate risk for instruments that are sensitive to interest rates and the bank's adherence to any related limits; early warning indicators of market risks; projections of on changes in interest rates, exchange rates, and other market indicators; as well as other measures.</p> <p>b) market risk limits, and</p> <p>c) exception tracking and reporting: Par. 28 sets out expectations for the Bank's Risk Management Committee to develop a risk appetite strategy and determine the size of aggregate levels of risk for each significant type or risk, which must be approved by the Board of Directors. With regard specifically to market risk, par. 45.2 sets a requirement for the bank to monitor its exposure to market risk to avoid breaching such limits. It must establish "procedures for immediately notifying the board of directors, the risk management committee, and other relevant divisions about reaching or violating those limits. When market risk limits are reached, the bank must undertake measures to reduce its exposures to market risk.</p> <p>d) controls for models: Under NBK Resolution No. 188, par 45.2, the bank is required to back-test its market risk assessment models on a periodic basis. This testing is meant to evaluate the reliability and effectiveness of market risk assessment models and enhance them where necessary. The results of back-testing with proposals to improve market risk management procedures, if necessary, are sent to the Risk Management Committee and the Bank's Board of Directors.</p> <p>e) allocation of exposures to the trading book: par. 44 requires the bank to determine the "structure of the trading and banking books, as well as the procedures for dividing instruments of the trading and banking books." The Resolution sets out an expectation that the trading book exists to support trading operations, realize</p>

	<p>profits through differences between the purchase and sale prices, and hedge exposures to various risks.</p> <p>The Agency evaluates these policies and procedures as part of the SREP process to determine whether the market risk management system allocates risks properly across the trading portfolio. Supervisors verify the existence of systems and controls to ensure regular revaluations of positions to market value; an information management system for monitoring transactions and identifying breaches of established limits; policies that define clear reasons for taking or avoiding certain types of risks, including with respect to reputational or other behavioral risks in financial markets; and systems for monitoring exposures to such risks.</p> <p>The qualitative analysis of the SREP examines elements of the risk management and internal control framework. This includes evaluating the bank's policies and processes that create an appropriate and appropriately controlled market risk environment.</p>
EC4	<p>The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC4	<p>NBK Resolution No. 188, par. 45.11, sets a requirement for banks to create procedures for assessing the fair value of financial instruments based on market data.</p> <p>With regard to models used to estimate the value of instruments, as noted earlier, a bank is required by the Resolution to back-test its models periodically (para. 45.2). The Resolution does not specify whether the models must be validated by a function that is independent of the business lines. The Resolution does embrace the concept of the three lines of defense, in which the second line is an independent operational risk management unit (par. 46.1), but it does not provide specific guidance to banks that risk models should subject to independent validation.</p> <p>However, the qualitative analysis of the SREP examines elements of the risk management and internal control system, including whether model validation is conducted by a function independent of the respective risk-taking units.</p> <p>The Resolution does not set expectations regarding the valuation adjustments necessary for positions and instruments that cannot be prudently valued, such as concentrated, less liquid, or stale positions.</p> <p>Assessors reviewed examples of inspection reports covering market risk and saw among other findings evidence that supervisors challenged the adequacy of a value-at-risk model as well as an example of a backtesting of a value-at-risk model over a 12-month period. Assessors reviewed, as well questionnaires prepared for inspectors to guide their evaluations of market risk, including supporting schedules that showed data such as interest rate gaps by currency.</p>

	Supervisory authorities should consider the inclusion of more specific guidance in the Resolution or related policies regarding model validation and the valuation of positions that are difficult to estimate prudently.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	<p>Market risk is included as a part of banks' internal capital adequacy assessment process (ICAAP) under NBK Resolution No. 188 (Chapter 5, beginning at par. 38). This process is meant to ensure that banks hold sufficient capital resources against their credit, market, and operational risk. It sets out expectations for stress testing, risk management procedures, and self-assessments, among other requirements. In this regard, market risk is required to be integrated into the internal risk management process; to support decision-making on current activities; and inform the development of the bank's strategy (Par. 43).</p> <p>It should be noted, however, that the ICAAP is still being implemented in Kazakhstan, and as a result no evidence exists yet demonstrating its effectiveness in helping banks to manage their risk exposures, including with regard to market risk.</p> <p>At present, the qualitative analysis of the SREP examines elements of the market risk management and internal control framework. Supervisors evaluate the bank's processes for determining and maintaining an appropriate level of capital for unexpected losses and any valuation adjustments related to uncertainties in determining the fair value of assets and liabilities. The SREP reviews and analyzes the existence of a capital contingency plan for adequacy and feasibility.</p>
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	<p>Stress testing has been introduced as a supervisory tool in Kazakhstan, but needs further improvements. Banks subject to stress testing recently completed the second iteration of a national stress test. However, at present the Agency has not yet implemented any "pillar 2 adjustments" that could increase the capital requirement for a particular firm based on the results of its stress test.</p> <p>NBK Resolution No,188 establishes requirements for stress testing of market risks to help banks assess their ability to withstand changes in the market environment. (This process is described beginning in Par. 45).</p> <p>Banks are required to define the frequency of stress testing, procedures, and methods of stress testing in their relevant internal policies and procedures relevant internal documents of the bank. The frequency of stress testing is determined based on the level of the bank's exposure to market risk, capital market volatility and other external factors, and is expected to increase in response to significant changes in market behavior (Par. 45.6).</p> <p>The Resolutions set out expectations for the kinds of scenarios (historical; assumptions regarding changes in foreign exchange and interest rates, in the market value of financial instruments, in profitability, in market volatility, and so on). The Resolution also requires the bank to submit the results of its stress testing to the Board of Directors, the Risk Management Committee and the Management Board of the Bank, and to other divisions of the Bank on a periodic basis. Where the results indicate that the bank has become vulnerable to certain risks, the resolution requires the bank to take steps to reduce its exposure to market risk.</p>

Assessment of Principle 22	Largely compliant
Comments	<p>Overall, supervisory authorities have described a set of requirements for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating market risk on a timely basis. However, key elements of international standards are still in development or in the process of being implemented in Kazakhstan, in particular the implementation of the ICAAP as well as the imposition of required increases in capital to reflect the results of stress testing. As these measures are more completely implemented, better evidence will become available of their effectiveness in encouraging banks to manage their exposure to market risk.</p> <p>Supervisory authorities are encouraged to clarify either in NBK Resolution 188 or related rules and regulations that models used for valuation of assets should be subject to independent validation. Moreover, supervisory guidance should require banks to establish policies for the valuation of positions that are difficult to estimate prudently.</p>
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁶⁹ in the banking book on a timely basis. These systems take into account the bank’s risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank’s strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank’s changing risk profile and market developments.
Description and findings re EC1	<p>There are no requirements for banks to have interest rate risk strategy. Interest rate risk management requirements are limited.</p> <p>Interest rate risk in the banking book (IRRBB) was considered part of market risk until December 2022, when Res. n. 188/2019 was amended to introduce requirement for banks to quantify IRRBB. Bank are requested to use at least two complementary methods to monitor its exposure to IRRBB:</p> <ul style="list-style-type: none"> quantitative assessment of changes in the economic value of equity (EVE)—i.e., calculation of the amount by which the net value of cash flows generated by claims and liabilities recorded in the bank’s balance sheet and off-balance sheet accounts will change. quantitative assessment of changes in net interest income (NII)—i.e., calculation of the amount by which the expected net interest income of the bank will change according to interest shock scenarios (a parallel shift of interest rates up and/or down).

⁶⁹ Wherever “interest rate risk” is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	Banks quantification should cover all essential sources of IRRBB inherent to transactions that are sensitive to changes in interest rates. Regarding interest rate sensitive financial instruments denominated in foreign currencies, the total amount of which exceeds 5 (five) per cent of assets (liabilities), the bank shall measure the interest rate risk separately for each foreign currency. The assumptions adopted within the methodology of interest rate risk evaluation shall be documented in the bank's relevant internal documents.
EC2	The supervisor determines that a bank's strategy, policies, and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies, and processes are developed and implemented effectively.
Description and findings re EC2	Supervision of IRRBB is at its infancy stage. The Agency pointed out that banks do not have a full understanding of IRRBB. ARDFM recently conducted a training session at one bank. Banks submit the two indicators (EVE and NII), but ARDFM does not verify the information, due to the lack of challenger model. Recently, ARDFM started working on an approach for quantifying capital add-ons for IRRBB, as part of the Pillar 2 framework. In 2022 technical assistance was delivered by the IMF to support the Agency's in the calibration of the amount of capital to be held for IRRBB based on measurement systems and a range of interest rate shock and stress scenarios. However, there is still no holistic approach on supervision of IRRBB.
EC3	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: <ul style="list-style-type: none"> (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary, and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	See EC2. The Agency has not identified those banks with a high exposure to IRRBB that could result in losses in a plausible range of market scenarios (outliers). The supervisor has not evaluated the adequacy, integrity and effectiveness of a bank's IRRBB management framework and assessed whether its practices comply with the objectives and risk tolerances set by its governing body.
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	Stress test requirement include 'all significant risks' to which the bank is potentially exposed (see CP15, EC13).
Additional criteria	

AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	
Assessment of Principle 23	Materially Non-Compliant
Comments	<p>Supervision of IRRBB is at its infancy stage. The Agency is raising awareness in the bank, via training, but so far this has taken place only at one bank. Banks were recently requested to quantify their exposure to IRRBB by submitting the two indicators (EVE and NII); however, such EVE is quantified only in relation to two out of the six scenarios prescribed by the Basel Committee for Banking Supervision; moreover, ARDFM does not verify this information, due to the lack of a challenger model. The draft Pillar 2 methodology on IRRBB was recently prepared, but never tested. ARDFM has not identified outliers. After the mission, the Agency presented some on-going work aimed at improving the supervision of IRRBB. This would take place through the expansion of the scenarios for EVE and the development of a challenger model. However, the concrete implementation remains to be seen.</p> <p>Recommendations</p> <p>The Agency should</p> <ul style="list-style-type: none"> • require banks to calculate EVE under the six scenarios prescribed by the Basel Committee for Banking Supervision. • develop a challenger model to initiate supervisory dialogue with banks on their exposure to IRRBB. • identify outliers. • roll out the Pillar 2 methodology on IRRBB.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than those prescribed in the applicable Basel standards.

Description and findings re EC1	<p>The prudential framework for liquidity risk is provided by:</p> <ul style="list-style-type: none"> • Banking Law art 42, which enables the supervisor to set prudential standards for liquidity ratio. • NBK resolution n. 170/2017 that sets out the minimum prudential requirements and limits for banks and contains liquidity prudential standards. • NBK Resolution n. 188/2019 '<i>Rules for formation of risk management and internal control system</i>', Chapter 6, which sets fourth requirements for ILAAP and liquidity risk management. <p>Prudential liquidity requirements</p> <p>Resolution No. 170/2017 Chapter 5 sets forth the following liquidity ratios:</p> <ul style="list-style-type: none"> • <u>Current liquidity ratio</u>: K-4. K-4 is set at 0.3 and it is computed as the average monthly amount of highly liquid assets and liquid assets of the bank with maturities on demand/under 7 days/under 3 months to the average monthly amount of liabilities with identical contractual maturity. • <u>Three quick liquidity ratios</u>: They are calculated as the average monthly high liquid assets to average monthly term liability with a remaining term to maturity up to seven days, one month and three months, respectively. <ul style="list-style-type: none"> (i) quick ratio K4-1 (7days) = 1 (ii) quick ratio K4-1 (1 months) = 0.9 (iii) quick ratio K4-1 (three months) 0.8 • <u>Three quick <i>currency</i> liquidity ratios</u>: They are determined as the average monthly in high liquid assets in foreign currency to average term liability in the same foreign currency with a remaining term to maturity of up to seven days, one month and three months, respectively. <ul style="list-style-type: none"> (i) Currency liquidity ratio K4-4 (7 days) = 1 (ii) Currency liquidity ratio K4-5 (one month) = 0.9 (iii) Currency liquidity ratio K4-6 (three months) = 0.8 <p>LCR and NSFR</p> <p>Resolution No. 170 Chapter 6 establishes the requirement for banks to measure the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). LCR and NSFR definition and calibration are the same as Basel framework. LCR became effective in September 2018 through a phased-in approach whereby banks initially needed to meet 50 percent and per January 1, 2022, 100 percent requirement. The NSFR became effective from January 1, 2019, with a minimum prudential requirement of 100 percent, after one year of monitoring period.</p> <p>During the <u>Covid-19 pandemic</u>, the Agency adopted liquidity supporting measures. It reduced LCR from 0.8 to 0.6 (March 30, 2020, to April 1, 2021) and relaxed the methodology for calculation both the LCR (reduction from 40 percent to 20 percent of the cash outflow liabilities to the Government, the NBK, international financial institutions, and local executive bodies) and the NSFR (until July 2021, banks were allowed to consider deposits of legal entities with the possibility of unconditional early withdrawal as part of stable funding instruments).</p>
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	<p>Moreover, the geopolitical risks put pressure on the Kazakhstan's financial sector. Along with inflationary and exchange rate pressures, the spillover effects included the need to preserve liquidity by the three subsidiaries of the Russian banks and the risk of local banks getting involved in transactions with sanctioned subjects and getting eventually hit by secondary sanctions. While NBK supported banks in need of liquidity, ARDFM had to postpone the full-fledged implementation of LCR and NSFR, which are both at 80 percent instead of 100 percent at the date of the assessment. Moreover, violation of LCR, NSFR and other liquidity ratios due to outflow of deposits, revaluation of assets and liabilities has been temporarily tolerated (from February 21, 2022, to December 31, 2022), subject to banks providing an action plan to address this violation within nine months. ARDFM should set LCR and NSFR at 100 percent as soon as feasible and work with impacted banks on a plan to restore liquidity buffers as needed.</p> <p>It should be noted that the definition of highly liquid assets for the quick and current ratio does not align with the high-quality liquid asset (HQLA) of the LCR: for example, overnight loans and deposits placed with banks do not qualify as LCR HQLA, whereas they do for the quick and current liquidity ratio.</p>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	<p>The prescribed liquidity requirements—particularly LCR and NSFR—do not reflect the liquidity risk profile of banks, as they are set at the same level for all banks.</p> <p>The Agency argued that (i) LCR and NSFR were introduced after observing a monitoring period; (ii) the qualitative analysis examines elements of the risk management and internal control system, including limits and sustainable remedies to mitigate and limit liquidity risk; (iii) attention is paid to the results of stress tests. Nevertheless, although ARDFM has the power to impose liquidity ratio above the minimum level (Banking Law Art. 46, par. 1 n. 1), it does not calibrate liquidity requirement to banks' risk profile.</p> <p>In 2022 the Agency received technical assistance (TA) by the IMF on "Risk-based supervision Pillar 2 Liquidity." The TA recommended that the Agency imposes liquidity prudential requirements above the minimum level on banks that are identified to have shortcomings in liquidity and funding risk and/or risk management system. The Agency is also working on a methodology for the assessment of bank's ILAAP, which can offer a robust motivation to calibrate prudential ratio to banks' risk profile.</p>
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	Pursuant to Resolution n. 188/2019 par. 4, the board of directors ensures that a risk management system is in place and matches the selected business model, scale of activity, complexity of operations, and provides an appropriate process for identifying, measuring, and evaluating, monitoring, controlling, and minimizing risks, in order to determine the bank's equity and liquidity necessary to cover significant risks inherent to the bank business.

	<p>ARDFM evaluates whether banks have a robust liquidity management framework as well as policies and procedures supporting a comprehensive bank-wide view of liquidity risk mainly through the SREP qualitative analysis. This analysis assesses elements of the risk management and internal control system, including issues related to liquidity risk management processes, risk appetites, limits, and indicators of early warning of liquidity risk and the results of stress testing. In addition, during the quantitative SREP assessment indicators are analyzed considering the acceptable limits provided by the prudential framework.</p> <p>Moreover, the Agency on a quarterly basis assesses the liquidity adequacy of banks based on: declining trend in LCR; aggressive growth of the loan portfolio and/or deterioration in the quality of loan portfolio; outflows on customer deposits; active borrowing of additional liquidity at the bank on the repo market; significant maturity gaps between assets and liabilities; increase in foreign exchange imbalances; NSFR and other prudential liquidity ratios. The results of this analysis are submitted to the Agency's management, and in case of identifying high risks, the supervisory unit is proposed to strengthen the monitoring of the liquidity of these banks.</p> <p>The assessors went through two risk assessment/SREP (one D-SIB and another no D-SIB bank) and noted that the weighted average of the liquidity risk profile is low (10 percent); hence its ability to influence the total score remains moderate.</p>
EC4	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite, and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	<p>ARDFM pointed out that under the SREP methodology qualitative analysis it examines, among other things, elements of the risk management and internal control system to determine whether the bank: (i) has a Risk Appetite Strategy that is subject to approval, regular monitoring, and review by the board (ii) ensures comprehensive reporting on its liquidity risk exposure and this is line with its risk appetite, risk profile, and systemic importance; (iii) regularly submit a statement of risk appetite to the Board of Directors, including when any limit is breached (for example, providing the bank's risk appetite compliance results to the board at least quarterly or more frequently is assessed as low risk).</p>

	<p>The assessors went through the qualitative risk assessment methodology. A set of questions should be answered by yes or no. Some questions are classified as ‘crucial’: if answered negatively, this implies the worst rating (of 4). Non-crucial questions help the supervisor to assess if an institution complies with key requirements related to the governance of liquidity risk management. The differentiation in “crucial” and “non-crucial” questions needs to be substantiated and reviewed on a regular basis, since the distinction has an important impact on the final SREP score for liquidity.</p> <p>Regulation n. 188/1019 requires banks to develop an effective process for identifying, assessing, monitoring, and controlling liquidity risk, including detailed forecast of cash flows by assets, liabilities, and off-balance sheet instruments at different time intervals.</p> <p>(a) as stated under CP14, EC5, the board of director should approve the risk appetite strategy, which includes liquidity risk appetite</p> <p>(b) banks should actively manage its intraday liquidity position and associated risks to timely fulfill payment and settlement obligations, both in normal and stressful situations, thereby contributing to the smooth functioning of payment and settlement systems. Bank shall manage intraday liquidity risk through procedures that include tracking daily liquidity positions considering expected cash inflows and outflows; forecasting the size of a potential financing gap arising in different periods of the trading day; identification of key customers acting as the main sources of incoming or outgoing liquidity flows; identification of key periods, dates and circumstances in which liquidity flows and possible credit needs are especially high; understanding the needs of business units; availability of reliable funding sources for intraday liquidity needs; management of assets that are used as collateral to obtain daily borrowed funds and operational mechanisms for collateral; measures in case of unexpected breaks in daily liquidity flows, including measures to ensure business continuity</p> <p>(c) banks should have an effective management information system to provide the board of directors, the risk management committee, and other interested structural units with information on the exposure to liquidity risk. The reporting system should: cover all sources of liquidity risk, including contingent liability; provide information on liquidity positions in the context of different time horizons; monitor the liquidity positions, both under normal and stressful conditions, by currencies, both individually and on an aggregated basis; monitor and analyze the dynamics of unencumbered highly liquid assets and factors affecting the stock held by the bank; assess and forecast future cash flows in the context of different time horizons, also considering the results of stress testing. The management reporting system includes the criteria, composition, internal procedure, and frequency of reporting on liquidity risk management to various recipients (for example, daily reporting to executives responsible for liquidity risk management; regular reporting to the management board, risk management committee and board of directors, with an increased frequency in periods of stressful situations). It should compare the liquidity risk level with the established limits, identify negative factors and ways to limit violations; report on violations indicating threshold, causes and remedies.</p> <p>(d) even though there is no explicit requirement for the board oversight, this can be inferred by the requirement related to effective information system reporting to provide the board with information on the exposure to liquidity risk, detailed under let (c)</p>
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	(e) policies and procedure for the management of liquidity risk and board's oversight over banks' liquidity risk strategy are covered under ILAAP requirement (see CP 15, EC5). For ILAAP, it is also required to do an annual self-assessment to identify weaknesses in the liquidity management policies; process organization; procedures, systems and regulatory actions, level of liquidity and the availability of funding.
EC5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders, and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	<p>Regulation n. 188/2019 Chapter 6 introduces funding strategy requirement. It also requires banks to consider the interaction between liquidity risk and other types of risks to which it is exposed.</p> <p>(a) The board of directors, the risk management committee and the management board shall be informed about the characteristics and diversification of funding sources and periodically review the funding strategy to immediately respond to changes in the internal and external environment. Banks identify alternative funding sources that increase their ability to withstand stressful situations and liquidity crises. Depending on the nature, severity and duration of the liquidity crisis, potential sources of financing include deposit growth; extension of maturities; issue of short-term and long-term debt instruments; intragroup transfers of funds, sale of subsidiaries or lines of business; asset securitization; sale of existing highly liquid assets or the conclusion of repo transactions; containing the increase in volumes in the main areas of activity (for example, slowing down the issuance of loans).</p> <p>(b) Bank shall have a constant stock of unencumbered highly liquid assets that might be used without significant losses and discounts under various stressful scenarios, including events that entail loss of access or reduction in the volume of liquid funds provided by creditors, comprising against collateral. Unencumbered highly liquid assets should be consistent with the liquidity risk appetite. The assessment of liquidity needs under current conditions and during periods of stress shall include both contractual and non-contractual cash outflows/inflows and consider the inability to obtain unsecured financing, as well as the loss or reduction of access to liquid funds. Liquidity reserve shall mainly be formed by the highest quality liquid assets, such as monetary funds, liquid government securities, finance marketing tools to be implemented in periods of stress scenarios and unencumbered liquid assets sold or used as security without significant loss or discount. General characteristics of highly liquid assets include transparency of structure and risk profile; ease and certainty of the assessment; existence of a liquid market in all stress scenarios; available volumes for the asset, including bank stocks</p>

	<p>relative to normal market turnover; absence of legal, regulatory, or operational barriers to using these assets.</p> <p>(c) Banks are required to diversify the funding sources and sets internal concentration limits, considering the types of funding sources in the context of products, tools, markets; the urgency of funding; the characteristics of the issuer, counterparty, or creditor, including economic sector, geographical location; the currency of funding sources. The diversification of funding sources is part of the financing plans (up to and over a year) and must be incorporated in the strategic and budget planning. Top 30 depositors account for about 11 percent of total deposits.</p> <p>(d) An important component of funding diversification is access to financial markets, which is crucial in the efficiency and ability to attract funds from investors and counterparties. Banks shall consider maintaining an availability in financial markets selected for funding purposes; strengthen the availability in selected financing markets; identify, establish, and maintain relationships with current and potential lenders providing funds; increase the capitalization to ensure the readiness of creditors to maintain relations with the bank. The board of directors, the risk management committee and the management board shall periodically evaluate and monitor the ability to quickly raise funds from each funding source to assess the effectiveness of ensuring liquidity in the long term.</p> <p>(e) to effectively manage collaterals, banks procedures should assess, among others, the conformity of each type of asset in relation to counterparties and secured financing markets; the volume relative to the capabilities of the financial market and counterparties; the price sensitivity, also considering various market stress scenarios. To assess how quickly assets are mobilized, banks should monitor the collateral by issuer, geographical location, and currencies, if necessary.</p>
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>Pursuant to Resolution n. 188/2019 Chapter 6, the board of directors approves a financing plan that clearly defines the process for eliminating liquidity shortages in emergency situations. The (contingency) financing plan corresponds to the scale of the bank's activities, risk profile, types and complexity of operations, assets, and the role of the bank in the financial system.</p> <p>The plan includes a clear description of a diversified set of adequate, affordable, ongoing potential measures to ensure unforeseen expenses to maintain liquidity and reduce the cash deficit in various adverse situations. It should contain: well-defined and accessible sources of financing in case of unforeseen circumstances, with an assessment of the possible amount of funds that are raised from these sources; the time required to attract additional funds from each of the sources of contingency financing; clear operating procedures governing bodies/units responsible for the development and implementation of the financing plan, the powers and areas of</p>

	<p>their responsibility, internal coordination and communication; detail actions, their prioritization, and options for implementing them. To ensure operational reliability, the financing plan is regularly tested and updated.</p> <p>ARDFM provided the assessors with a bank's contingency funding plan, but it did not submit an example on how the Agency assesses contingency funding plan.</p>
EC7	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies, and positions and to develop effective contingency funding plans.</p>
Description and findings re EC7	<p>Resolution n. 18/2019 Chapter 6 requires bank to periodically conduct stress testing on various factors of short-term and long-term scenarios, oriented both to idiosyncratic risk and large-scale market stresses and the combination of both scenarios, to analyze and quantify their impact on the level of liquidity, cash flows, profitability, and solvency. The results of stress tests shall be reviewed by the board of directors, and based on the results of the review, banks shall take measures to eliminate or mitigate the negative consequences, create the necessary liquidity reserve, and adjust the liquidity level. The results of stress tests play a key role in formulating a bank contingency financing plan and in determining a strategy and an ILAAP.</p> <p>Moreover, Resolution n. 18/2019 Chapter 6 provides for articulated framework for liquidity risk stress testing:</p> <ul style="list-style-type: none"> • Bank shall analyze the impact of stress scenarios on the liquidity position, estimates the level of liquidity risk when the internal and external environment changes, at different time periods (short-term, long-term), including on an intraday basis. The degree and frequency of stress testing should be consistent with the business model, the scale of activity, the complexity of operations, and the role of the bank in the financial system. The bank shall have the ability to increase the frequency of stress testing in worsening market conditions or at the request of the board of directors or risk management committee. • The board of directors of the bank shall take part in the stress testing process by approving procedures and scenarios, evaluating the results, and taking measures to minimize the identified risk. The board of directors integrates the results of the stress testing process into the strategic and budget planning process, as well as contingency financing plan, including for purposes of correcting deficiencies in the plan. • The results of stress testing shall also be used to establish internal limits. • Banks shall consider the possible behavioral response of other market participants to stress events and the extent to which the overall result strengthens market movement and aggravates the market load. <p>Scenario</p> <p>Scenarios include all the main funding and liquidity risks in the market to which the bank is potentially exposed. Banks should consider scenario related to simultaneous lack of liquidity in several previously highly liquid markets, serious difficulties in accessing secured and unsecured funding, currency convertibility restrictions, serious</p>

	<p>operational or settlement failures affecting one or more major payment or settlement systems. Stress scenarios should be analyzed by the bank on a regular basis to confirm their relevance, considering changes in market conditions, nature, volume of assets, complexity of the business model and activities, and actual experience in situations of stress. Scenarios and relevant assumptions shall be documented and considered along with the results of the stress test.</p> <p>Banks should take a conservative approach in determining the assumptions of stress testing, including narrowing market-wide liquidity; outflow of retail and corporate funding; lack of access to new secured and unsecured sources of funding; need for significant discounts for the sale of assets and (or) repos; default of counterparties, including on the interbank market; margin calls; changes in the timing of financing; contingent liabilities for off-balance sheet instruments and operations, including credit lines; non-renewability of interbank deposits; inability to use credit lines provided to the bank; impact of triggers on a significant decrease in credit ratings; decrease in the ability to sell liquid assets (legal, regulatory, operational and time constraints); limited access to funds of the authorized body or companies of the quasi-public sector; limited ability to sell assets; negative information impacting the reputation.</p> <p>During the SREP qualitative analysis, the Agency assesses the adequacy of the stress testing through a questionnaire whereby supervisor should consider the degree and frequency of stress testing; the integration of stress test results into the overall liquidity risk management system; regular review and update of stress test assumptions and scenarios; presentation of the results to the board of directors.</p>
EC8	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>Based on the results of the regular liquidity assessment, ARDFM initiated a request for banks to calculate the LCR broken down by currencies, to analyze the currency imbalances.</p> <p>Considering that about 1/3 of deposits is in foreign currency, the Agency should consider expanding prudential return on liquidity risk by introducing the measurement and reporting of the LCR per significant currency which will reveal and better capture potential currency mismatches. This should make supervisors and banks should be aware of the liquidity needs in each significant currency. The Agency should engage in a more intrusive supervisory dialogue with banks dependent on foreign currency funding, and set limits on the size of cash flow mismatches for foreign currencies in aggregate and for each significant currency individually.</p>
Additional criteria	
AC1	<p>The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the</p>

	implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	
Assessment of Principle 24	Largely Compliant
Comments	<p>Prudential requirements are below the Basel standards (LCR and NSFR 80%) and temporary prudential support to mitigate the impact of the imposed sanctions is still in place: the violation of LCR, NSFR, other liquidity ratios, limits of net position, and allocation of funds in domestic assets due to outflow of deposits, revaluation of assets and liabilities is allowed, subject to banks providing an action plan to address this violation within 9 months. Liquidity requirements do not reflect the risk profile of banks, as they are set at the same level for all banks. ARDFM assesses liquidity risk during the SREP, but this is partially untested as banks will submit their first ILAAP at the end of the mission. As 1/3 of deposits is in foreign currency, LCR in tenge does not fully capture currency liquidity mismatches.</p> <p>Recommendations:</p> <p>The Agency should:</p> <ul style="list-style-type: none"> • exit liquidity forbearance measures and set up LCR and NSFR at 100 percent. • enforce sanctions in case of violation of prudential liquidity requirements. • structurally assess liquidity contingency funding plans. • perform a more thorough monitoring of liquidity in foreign currency (including liquidity stress test in foreign currencies). • reconsider the weight of liquidity risk in the overall SREP score which seems low (10 percent). • test the methodology for assessing ILAAP, also based on the deficiencies in the liquidity risk management and internal control system, and calibrate liquidity prudential requirements to banks' risk profile. <p>To capture potential currency mismatches, ARDFM could also consider introducing LCR per significant currency, since about 1/3 of deposits are in foreign currency.</p>
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁷⁰ on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the

⁷⁰ The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	<p>bank's strategy, policies, and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).</p>
Description and findings re EC1	<p>The Agency instituted a new operational risk requirement at the beginning of 2023, relying on the basic approach. Information on operational losses (a monitoring report on operational risk events leading to losses) is provided as part of reporting in accordance with the requirements set forth in Resolution No. 54 of NBK dated April 21, 2020. According to these requirements, the operational loss amount includes imposed and collected fines, court fees and penalties, out-of-court compensations paid to bank clients and employees, and other losses over 500,000 tenge.</p> <p>As this requirement has just been instituted, time will be required to determine its effectiveness. No evidence exists yet demonstrating its effectiveness in helping banks to manage their risk exposures, including with regard to operational risk.</p> <p>Ultimately this information will be used to assess operational risk by the supervisory agency as part of the annual SREP cycle as it assesses quantitative indicators (capital requirements as regards operational risk and the ratio of the operational loss to the amount of operational risk). For example, total operational losses divided by total operational risk reflects the level of current operational losses in the latest reporting period in relation to capital and is an indicator of a bank's capacity to absorb operational losses.</p> <p>Agency staff evaluate the operational risk management framework largely through onsite supervision, and curators have the ability to monitor compliance daily during the SREP exercise.</p> <p>During the onsite assessment of the Core Principles, assessors reviewed inspection reports that evidenced detailed and specific findings about operational risk exposures that required corrective measures.</p> <p>Requirements for an operational risk management system are established by NBK Resolution No. 188, Para. 46.</p> <p>Paragraphs 46-52 of Resolution No. 188 set forth the requirements for operational risk management, including creating an operational risk management system that is integrated into the bank's overall risk management processes. This includes defining the interactions between all involved participants in the operational risk management process; describing the tools used to measure operational risk; an internal procedure for determining the operational risk appetite level; procedures for internal reporting; a system for classifying operational risk events; an analysis of operational risk and any policy revisions necessary to address a significant change in the level of operational risk, among other requirements.</p> <p>Operational risk is included as a part of banks' internal capital adequacy assessment process (ICAAP) under NBK Resolution No. 188 (Chapter 5, beginning at para. 38). This process is meant to ensure that banks hold sufficient capital resources against their credit, market, and operational risk. It sets out expectations for stress testing, risk management procedures, and self-assessments, among other requirements. In this regard, operational risk is required to be integrated into the internal risk management process; to support decision-making on current activities; and inform the development of the bank's strategy (Par. 43).</p>

EC2	The supervisor requires banks' strategies, policies, and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	<p>The ARDFM has in place a foundation for a supervisory framework for operational risk exposures. For operational risk, the review of a bank's strategies, policies, and processes for the management of operational risk is principally carried out through onsite supervision, but also through curators' monitoring of firms, and through the SREP process.</p> <p>With regard to requiring banks to approve and review management's approach to mitigating operational risk, under NBK Resolution No. 188, par. 47, a bank's board of directors is responsible for approving the bank's operational risk management policy, forming the operational risk management culture, requiring a regular analysis of the operational risk management system to ensure the timely identification and management of operational risks, promoting appropriate conditions to apply the best operational risk management practices, and approving and controlling compliance with risk appetite levels related to operational risk.</p> <p>The Board's Risk Management Committee is responsible for ensuring regular monitoring of the level of operational risk.</p> <p>The banks also ensure availability of a management information system, including establishment of an internal procedure determining composition and frequency of reports on operational risk management submitted to various recipients, responsible persons (departments) of the bank for preparation and communication of information to relevant recipients.</p> <p>Under Resolution No. 188, Boards are required to conduct self-evaluations of the bank's exposure to operational risk and provide this to the Agency once per year.</p>
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	<p>Resolution No. 188 establishes that a bank's Risk Management Committee ensures the existence of a process for regular monitoring of the level of operational risk. (Para. 48.7). This work is done through onsite inspections, offsite monitoring by curators, and the periodic SREP exercises.</p> <p>The Bank must ensure the availability of the management information system, including establishing internal procedures that set the composition and frequency of internal reporting on operational risk management. The procedures must define responsible persons (or departments) of the bank that prepare and communicate operational risk-related information to the relevant recipients (Para. 49).</p>
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	Res. N. 188, Chapter 7 sets out requirements for banks to create a business continuity plan (Par. 62).

	<p>Under para. 68, the bank's plan must be understandable and available for use by responsible executives; have goals consistent with business continuity, such as identifying critical activities and identifying the maximum allowable downtime and target time for recovery; describes the functions and responsibilities of personnel involved in the continuation or recovery of activities; have an activation scheme and a decision-making process for doing so; identify the necessary emergency external and internal communications; contain all necessary details, such as location of back-up facilities, travel routes, relevant contacts in the Agency and other authorities; and a sole owner responsible for reviewing and updating the plan, among many other requirements.</p> <p>The Resolution lays out requirements as well for banks to test these plans to verify their reliability and improve them where necessary (Para. 70).</p> <p>In addition, NBK Resolution No. 48 sets out requirements for banks to ensure the security of their information and manage their cybersecurity risks. These rules require banks have backup storage of information systems data, files, and settings so that the bank can recover a workable copy of its information system (Par. 48 of Chapter 5).</p> <p>However, the Agency's cybersecurity resources are constrained. It has lost talent to the private sector such that, at the time of this assessment, only one staff member holds an internationally recognized professional certificate related to information technology security. It will be important for the Agency both to train its existing IT and cybersecurity supervisors to strengthen their skills in this area and to recruit staff with appropriate professional expertise to strengthen its supervision of IT-related risks. This includes encouraging its staff to attain internationally recognized professional certification in this important area of operational risk.</p>
EC5	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor, and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings re EC5	<p>Res. No.188 (Chapter 8, Par. 72) requires the Board of Directors of the bank to ensure the availability of information technology risk management system that corresponds to the external operating environment, strategy, organizational structure, volume of assets, nature and level of complexity of bank operations and ensures minimization of information technology risks.</p> <p>The information technology risk management system must include IT risk management policies and procedures; a relevant management information system; and evaluations by internal audit of the IT risk management system, among other requirements. (Para. 73)</p> <p>With regard to the information technology infrastructure, Para. 74 of Res. No. 188 requires banks to include in the risk management system the risk management function as well as the information technology unit.</p> <p>Article 75 sets out functions that the structural unit for IT risk management should include, such as the development of a risk management system for IT; participation in the implementation of the bank's strategy to ensure the availability of information and communication technologies; participation in the assessment of and monitoring</p>

	<p>of risk in information technology; planning and analyzing a risk assessment of information technology; reporting on the implementation of measures to mitigate information technology risk to the risk management committee and reporting to the board of directors as well, among other requirements.</p> <p>Article 76 continues with a description of the functions that the structural unit should include, such as conducting an IT risk assessment; developing measures for IT risks and reporting on their implementation to the risk management unit; preparing reports on significant risks and on efforts to mitigate them.</p> <p>Separately, as noted in the assessment of Essential Criterion 5, NBK Resolution No. 48 sets out requirements for banks to ensure the security of their information and manage their cybersecurity risks.</p> <p>As discussed earlier in EC4, the Agency's cybersecurity resources are constrained at this point in time, and it will be important for the Agency to make the necessary investments in its capacity by training existing staff and hiring candidates with appropriate professional skills and experience to strengthen its management of IT and cybersecurity risks. Our assessment seeks to balance the existence of a relevant operational risk scenario with the ongoing challenges to maintain sufficient resources to be effective.</p>
EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyze operational risk data, and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>As noted above, ARDFM supervisory staff conduct onsite work to ensure that supervised banks (a) monitor operational risk, which include evaluating the information systems that banks maintain to monitor this and other risks.</p> <p>With regard to (b) compiling and analyzing operational risk data, the ARDFM recently adopted the basic indicator approach and separately intends to require banks to collect data on operational losses above 500 thousand tenge. However, this data collection requirement was not yet in force at the time of this assessment, and assessors consequently cannot express an opinion on its implementation. That said, through discussions with supervisory staff and reviews of supervisory reports, assessors did note that supervisors and curators are focusing on this issue. For example, under NBK Resolution No. 188, the Bank must ensure the availability of the management information system, including establishing internal procedures that set the composition and frequency of internal reporting on operational risk management. The procedures must define responsible persons (or departments) of the bank that prepare and communicate operational risk-related information to the relevant recipients (Para. 49).</p> <p>In this regard, as noted in Para. 78 of NBK Res. 188, the information technology unit is responsible for ensuring the availability of information and communication technologies to support critical business processes, including identifying budgetary and technology needs. The bank itself is required to ensure the existence of a management information system as well as the policies that define the criteria for reporting. As noted earlier in this assessment, and with regard to subpoint (c) above,</p>

	the audience for these reports include relevant senior management, the risk management committee of the board of directors, and the board of directors itself.
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	<p>As noted above, Res. No. 188 sets a number of requirements for banks to maintain an appropriate management information system related to operational risk as well as reports created for relevant senior management, the risk management committee of the Board of Directors, and the Board of Directors itself.</p> <p>While the Resolution only occasionally refers to reports required to be provided to the supervisor, the Resolution notes a responsibility for a bank's internal audit to evaluate the effectiveness of risk management and reporting processes for the bank's own management and the Agency (Para. 113.4). In addition, as noted throughout this assessment, the Agency and especially its curators have the ability to request any documentation from the bank and to participate in meetings as observers.</p> <p>The Resolution or related regulations could be improved by setting an explicit requirement for banks to report operational risk developments to the Agency.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment, and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>When outsourcing of individual operations and (or) implementation of business processes, the Board of Directors of the bank shall ensure that effective principles and practices of risk management resulting from outsourcing are in place.</p> <p>Chapter 13 of Res. No. 188 establishes a minimum list of actions required when outsourcing, which include establishing procedures for determining which functions may be outsourced; process for conducting due diligence on the financial condition of external contractors; setting principles for entering into contracts with external parties, including considering their ownership structure; and establishing effective controls at the bank and at the party that has contracted with the bank, among other requirements. During the assessment, assessors did not see evidence of such reviews taking place.</p>
Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).

Description and findings re AC1	
Assessment of Principle 25	Largely Compliant
Comments	<p>Supervisory authorities have adopted rules and regulations on the adequacy of operational risk management frameworks in banks in Kazakhstan. However, supervisors have not yet implemented these rules fully, especially the adoption of the basic indicator approach and the ICAAP, and assessors did not see evidence that reviews of outsourcing risk have been undertaken yet. As these measures are more completely implemented, better evidence will become available of their effectiveness in encouraging banks to manage their exposure to operational risk.</p> <p>Finally, information technology and cybersecurity represent key sources of operational risk in many banks. Given that the Agency's resources in especially cybersecurity are constrained at the moment, it is important for the Agency to invest in the training of existing staff and the recruitment of professionals with appropriate skills and expertise to enhance its capacity in this important area of operational risk. This includes encouraging its staff to attain internationally recognized professional certification in this important area of operational risk.</p>
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁷¹ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <p>(a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance);</p> <p>(b) accounting policies and processes: reconciliation of accounts, control lists, information for management;</p>

⁷¹ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>(c) checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures, and</p> <p>(d) safeguarding assets and investments: including physical control and computer access.</p>
Description and finding re EC1	<p>NBK Res. 188 specifies that banks must maintain a system of internal controls that is “consistent with the current market situation, strategy, volume of assets, and level of complexity of bank operations” (Par. 98).</p> <p>a) Regarding the organizational structure, the resolution specifies that the board of directors is responsible for forming the control environment (Par. 99), which includes establishing the principles for the control environment, identifying the skills required of staff, outlining how to implement the “three lines of defense” (para. 100.5) and articulating the accountability of each line.</p> <p>b) Expectations for accounting policies can be found throughout the resolution, and particularly in para. 37 (accounting and financial reporting controls), para 42 (credit).</p> <p>c) Checks and balances: Resolution 188 articulates other requirements such as internal reporting, checks and balances such as the “four eyes principles” (Para. 104) and segregation of duties (“separation of powers,” par. 102.2).</p> <p>d) Safeguarding assets: para. 104 describes responsibilities for controls over assets, including physical assets as well as over records, and measures to prevent fraud (para 11.4).</p> <p>These controls and their effectiveness are assessed during SREP reviews onsite.</p>
EC2	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank’s Board) to be an effective check and balance to the business origination units.</p>
Description and findings re EC2	<p>Paragraph 100.2 of NBK Resolution No. 188 notes that banks are required to articulate the professional requirements for staff involved in control functions. However, it should be noted that the Agency lacks the ability to conduct fit and proper testing of senior managers in control functions, such as the chief risk officer or the head of internal audit. While the ARDFM is encouraged to align its fit and proper testing with senior managers in control functions as well, the assessors have already assessed this gap in Core Principle 5 (Essential Criterion 7) and will not address this gap here.</p> <p>The Agency evaluates the level and quality of staff resources within a bank as part of its supervision of banks, including the SREP process. Assessors evaluated a number of inspection reports, including those of internal control functions in supervised banks, and found that the reports were generally detailed and offered adequate evidence to support findings. In most cases, the reports included clear statements about deficiencies that must be remediated.</p>

EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function ⁷² that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function is suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	<p>Paragraph 20 of NBK Resolution No. 188 sets out requirements for a bank's corporate governance and identifies explicitly a requirement to establish a "compliance control unit." The Resolution identifies the compliance unit as an independent unit (para. 21.14) within the second line of defense. The Board of Directors is responsible for appointing the head of this compliance unit (chief compliance controller) under Paragraph 21.11. unit.</p> <p>Paragraphs 89 and 110 give more insight into how the compliance unit maintains its independence, such as by having an independent structure, not allowing compliance staff to hold other roles within the bank, avoiding conflicts of interest, and having access to any information necessary to fulfill their duties. Paragraph 91 similarly describes how the head of compliance maintains independence from the bank, such as by being appointed by the board of directors, having direct access to the board of directors, has access to any information necessary, and holds no other operational role in the bank. Paragraph 110 furthermore specifies that the head of internal audit is accountable directly to the board of directors; in the event that the board dismisses the head of internal audit, it is expected to report the rationale to the Agency.</p> <p>As noted earlier, assessors reviewed examples of inspection reports and noted adequate evaluations of a bank's internal controls. However, the Agency does not have the authority to conduct fit and proper testing of the chief compliance officer.</p>
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁷³ charged with:</p> <p>(a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business, and</p> <p>(b) ensuring that policies and processes are complied with.</p>
Description and findings re EC4	NBK Resolution No. 188 notes that the board of directors appoints the head of internal audit (para. 20.11) and describes it as an independent function that comprises the third line of defense (para. 21.14). Paragraphs 108-109 offer additional insight into how the head of audit and the audit function maintain their independence, including by being accountable to the board of directors, by not having other responsibilities in the bank and by having sufficient resources and authority to access any necessary information to carry out their duties. The board of directors must be required to remediate violations and deficiencies that the internal

⁷² The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

⁷³ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	<p>audit function identifies. Under the Resolution, internal audit functions are guided by international standards for internal audit (Para. 108).</p> <p>The Agency evaluates the quality of internal audit through its onsite supervision, including as part of the SREP methodology. The Agency assesses the risk management system, including all spheres of activity of the organization, the presence of three or more levels of protection, and the presence of audit service / audit collegial body. The onsite reviews include evaluating whether the internal audit function is accountable to and reports to the board and whether the bank addresses internal audit’s findings.</p> <p>As noted earlier, the Agency does not have the authority to subject the head of internal audit to fit and proper testing as it does other senior executives in a bank.</p>
EC5	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank’s Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank’s risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly, and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	<p>The Agency evaluates the audit function's role as a third line of defense as part of its SREP process, which includes evaluating the audit committee and management involvement in its work, the audit process regulations (availability of audit plans, ability to update), audit coverage (whether all areas of the organization are covered), and interaction with other parts of the organization. In addition, the Agency considers the availability of relevant skills and knowledge to fully understand and perform the tasks is analyzed. As part of its SREP reviews, the Agency validates the qualification of the internal audit staff, the training offered, and the sufficiency of staff. It also considers the findings of external audit’s reviews of the internal audit function.</p> <p>The responsibilities banks have to create an audit function are described in NBK Resolution No. 188. Paragraph 108 sets out the responsibility for the bank to ensure that the internal audit unit has “sufficient resources and powers” to conducts its role “objectively and efficiently” As noted above, paragraphs 20, 89, and 110 lay out requirements for the bank to preserve the internal audit function’s independence. Moreover, the Resolution requires the board of directors to remediate violations of deficiencies identified by internal audit (para. 109.5). Paragraph 110.2 identifies the bank’s responsibility to articulate the qualifications and skills necessary for internal audit staff.</p>

	<p>The audit function's powers are described in paragraph 111.8, including the ability to evaluate any unit and activity of the bank, and "unlimited access to bank documents, data, material objects, management reporting, records and minutes of all meetings and meetings-adopted decisions."</p> <p>The head of internal audit is responsible for drafting the annual audit plan grounded in a risk-based approach and a risk assessment (para. 115) and taking into consideration the strategy, organizational structure, assets, and complexity of the bank's operations (para. 108). This includes assessing:</p> <ol style="list-style-type: none"> 1) the effectiveness of the risk management system and internal control; 2) the effectiveness of bank policies and procedures; 3) the reliability of the accounting system and information; 4) the reliability, efficiency and integrity of management reporting systems (including relevance, accuracy, completeness, accessibility, confidentiality and the comprehensive data), and 5) the safety of assets and capital." (par. 112). <p>For any outsourced functions, the Resolution does not explicitly indicate that internal audit can or should review these activities. However, the Resolution indicates that the board of directors is required to establish principles and practices for mitigating risks associated with outsourcing, including risk management and effective controls (par. 116). It would be stronger and clearer if the Resolution or other supervisory guidance clarified that Internal Audit should review outsourced activities, but the lack of this specific statement is not viewed as a significant deficiency.</p>
Assessment of Principle 26	Compliant
Comments	Overall, NBK Resolution 188 outlines sufficient guidance to meet the essential criteria associated with CP 26 on internal controls and internal audit. Assessors' reviews of inspection reports and other documents prepared by Agency staff suggest that the Agency is conducting credible oversight of these functions. While fit and proper testing of senior leaders in control functions is not a requirement of the Core Principles, the Agency already conducts such reviews of senior business leaders within supervised banks, and so it should conduct similar reviews of senior leaders involved internal control functions. Finally, for outsourced functions, the Agency is encouraged to clarify in its guidance that internal audit must have the authority and resources necessary to evaluate risks associated with tasks undertaken on behalf of the bank by third parties.
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	

EC1	The supervisor ⁷⁴ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	<p>In Kazakhstan, the Ministry of Finance upholds accounting standards with the exception of those that apply to financial institutions. The NBK oversees accounting standards that apply to financial institutions and establishes the chart of accounts. The ARDFM can nonetheless propose amendments. While the ARDFM is the implementing agency and evaluates compliance with accounting standards in supervised banks, it may invite the NBK to provide assistance in its review.</p> <p>According to para. 4 of Article 2 of the Law of the Republic, "On Accounting and Financial Reporting," financial organizations (with the exception of organizations engaged in microfinance activities that are small and medium-sized businesses) carry out accounting and financial reporting in accordance with international financial reporting standards (hereinafter—IFRS) and regulatory legal acts of the NBK on accounting and financial reporting.</p> <p>B.L. Art 54 determines that banks keep records of transactions and events in accordance with legislation of the Republic of Kazakhstan on Accounting and Financial Reporting and IFRS. Article 55 sets out a requirement for banks to publish audited consolidated financial reports annually as well as quarterly statements on the balance sheet and profit and loss that are not required to be audited.</p> <p>Under NBK Res. No. 188, par. 5, the board of directors of a bank is responsible for the "timely and reliable disclosure of information" consistent with the banking law, the law on state regulation, and related laws. In addition, paragraph 21.14 notes the responsibility of the bank's compliance control unit to comply with the country's accounting and financial reporting requirements.</p>
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	As part of the risk management system in accordance with NBK Res. No. 188, Par. 26.2, the audit committee of the bank's Board of Directors oversees engagements with the bank's external auditor, including reviewing the external auditor's certification of the bank's annual financial statements for publication. The audit committee is furthermore responsible for consideration the external auditor's recommendations and ensuring the mitigation of deficiencies that the external auditor identifies.
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.

⁷⁴ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

Description and findings re EC3	As part of the risk management system in accordance with NBK Res. 188, paragraph 43, the board of directors is required to ensure that the bank maintains a market risk management system that ensures the effective identification, measurement, and mitigation of market risk. This includes a requirement in paragraph 45.11 that the bank have procedures for calculating the "fair value of financial instruments based on market information." Paragraph 45 describes measures banks are expected to check their valuation estimates, including the use of back-testing, but does not specifically require independent verification and validation.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality-based approach in planning and performing the external audit.
Description and findings re EC4	According to B.L. Art. 57, the bank must be audited by an external auditor authorized to conduct an audit in accordance with the legislation on auditing activities and in compliance with the requirements of B.L. Art. 19, par 4. Paragraph 4 sets out requirements for an external auditor to be independent of the bank to be audited and licensed by the appropriate authority in Kazakhstan. Expectations are not set for how the external auditor determines the audit plan. As noted above, the ARDFM ensures compliance with auditing requirements through its onsite reviews.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	We note that under B.L. Art. 57, par. 8, the plan for auditing other information with a description of the proposed areas, scope, nature of the audit, the features used in the audit of methods and standards, is subject to prior approval by the audit organization with the authorized body. The Agency establishes, in coordination with the authorized state body performing state regulation in the field of auditing activities and control over the activities of auditing and professional auditing organizations, the list of issues subject to audit in the audit of other information, requirements for the content, timing of the auditor's report on the audit of other information, requirements for auditors in the auditing organization, involved in the audit of other information.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	The external auditor shall be selected by the Board of Directors of the bank. In order to conduct a mandatory audit of financial organizations, an auditing organization shall comply with the minimum requirements established by the Ministry of Finance of the Republic of Kazakhstan. However, supervisors do not have the ability to reject the selection of an auditor. In addition, the supervisor cannot place restrictions on the offering of both auditing and consulting services by the same firm to one bank to reduce conflicts of interest. Finally, auditors are not obliged under law to report circumstances that could have a significant impact on the reliability of audited financial statements. At present, the Ministry of Finance sets standards for external regulators and has not permitted the Agency to reject the selection of an auditor.

EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	According to the minimum requirements for audit organizations, an audit organization conducting a mandatory audit is subject to rotation if it audits one organization, including a financial organization, continuously for 7 years.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	The Agency reports that it meets with external audit firms occasionally but not regularly. Agency staff indicated that they typically meet with external auditors prior to conducting inspections. For example, Agency staff may ask an audit firm for an explanation about deviations in opinions and conclusions regarding financial reporting and (or) other information related to financial reporting, in terms of evaluating assets, liabilities, and contingent liabilities of banks, bank holding companies, and organizations in which the bank and (or) bank holding is a major participant. However, the Agency does not regularly meet with external audit firms to hear views on emerging issues, etc.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	According to the Law "On Auditing Activities," audit organizations are required to notify the competent authority for regulation, control, and oversight of the financial market and financial organizations with notice to the audited subjects about violations of legislation identified as a result of the audit of financial organizations, organizations that are part of a banking group, organizations that are part of an insurance group for which the audit is mandatory.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	
Assessment of Principle 27	Largely Compliant
Comments	<p>Overall, supervisory authorities have adopted rules and regulations that are broadly aligned with international standards regarding financial reporting and external audit, including correcting some deficiencies noted at the prior assessment related to the rotation of external auditors. However, the Agency is not empowered to reject or rescind the selection of an external auditor that it considers to be inadequate, insufficiently independent, or not aligned with established professional standards. The ARDFM furthermore lacks the ability to establish the scope of external audits.</p> <p>At the time of the assessment, the ARDFM did not require fair value estimates to be subject to independent verification and validation.</p> <p>When supervisors have material concerns about the capability of an external auditor, it is important that they be able to require a bank to hire a more competent auditor to improve confidence in the auditor's findings. The ARDFM should have this power.</p>

	Supervisors should also have the power to limit conflicts of interest that may arise when an auditor provides consulting services to the same client. Finally, the ARDFM should meet regularly with external audit firms to hear views on emerging issues, etc.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁷⁵ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>In accordance with B.L. Art. 55, banks are required to publish an annual consolidated financial statement or, in the absence of a subsidiary, an unconsolidated financial statement. They must also publish the audit report after confirmation by the audit organization that the report meets regulatory requirements and that the information is reliable, in addition to meeting other regulatory requirements.</p> <p>On a quarterly basis, banks must publish their balance sheets, income and expenses statements that comply with international financial reporting standards (Art. 55.1).</p> <p>The procedure and terms are established by the following regulatory legal acts of the Agency:</p> <ul style="list-style-type: none"> • NBK Resolution No. 282, "On approval of the rules for publication of financial statements by Joint-Stock Companies and financial organizations, reporting on accounting data by branches of non-resident banks of the Republic of Kazakhstan, branches of insurance (Reinsurance) organizations of non-residents of the Republic of Kazakhstan, branches of insurance brokers of non-residents of the Republic of Kazakhstan." • NBK Resolution No. 138, "On the procedure and timing of publication of financial statements by banking and insurance holdings." <p>At the request of the Agency, banks must post the other reports on the Internet in accordance with the list and deadlines established by the regulatory legal act of the Agency (Art. 55.1).</p> <p>The Agency has not yet adopted the "Pillar 3" elements of the Basel capital framework that requires certain disclosures to improve market discipline of banks. It plans to do so in 2030.</p>
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.

⁷⁵ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

Description and findings re EC2	<p>Article 55 of the Banking Law requires the publication of annual consolidated reporting as well as quarterly reporting of the balance sheet and profit-and-loss statements in accordance with international financial reporting standards.</p> <p>In addition, a variety of other laws and regulations set out reporting and disclosure requirements, as indicated below.</p> <p>In accordance with NBL Law Article 15, B.L. Art. 54 and Article of 16 of the Law of the Republic of Kazakhstan, "On State Statistics", NBK asserts the list, forms, deadlines and reporting procedure of financial organizations. These requirements apply to the major participants of financial organizations, banking holding companies, banking groups, insurance holdings, insurance group, joint Stock Company "Development Bank of Kazakhstan", branches of non-resident banks of the Republic of Kazakhstan, branches of insurance (reinsurance) organizations -non-residents of the Republic of Kazakhstan, branches of insurance brokers-non-residents of the Republic of Kazakhstan, an organization guaranteeing insurance payments, credit bureaus and collection agencies in coordination with the authorized body for regulation, control and supervision of the financial market and financial organizations.</p> <p>The list, forms of financial and other reporting of banks, including the financial and other reporting on a consolidated basis, terms and procedure for its submission to the National Bank of the Republic of Kazakhstan are established by the following regulatory legal acts of the National Bank of the Republic of Kazakhstan in coordination with the Agency:</p> <ul style="list-style-type: none"> • Resolution of the board of the NBK No. 54, "On approval of the list, forms, deadlines and Rules for reporting by second-tier banks." • Resolution of the board of the NBK No. 75, "On approval of the list, forms, deadlines for reporting on compliance of the Prudential Standards by second-tier banks and the Rules for their submission." • Resolution of the board of the NBK No. 313, "On Approval of the list, forms, terms and rules of reporting on Loans and Contingent Liabilities by second-tier Banks, branches of non-resident banks of the Republic of Kazakhstan, Joint-Stock Company "Development Bank of Kazakhstan" and Organizations engaged in certain types of banking operations." • Resolution of the Board of the NBK No. 41, "On Approval of the Rules of the submission of Financial Statements by Financial Organizations." • Resolution of the Board of the NBK No. 211, "On approval of the list, forms, deadlines for reporting by licensees operating in the securities market, by a single operator and the Rules for its submission." <p>The list, forms of reporting on accounting data and other reporting of branches of non-resident banks of the Republic of Kazakhstan, the terms and procedure for its submission to the National Bank of the Republic of Kazakhstan are established by regulatory legal acts of the National Bank of the Republic of Kazakhstan in coordination with the authorized body:</p> <ul style="list-style-type: none"> • Resolution of the Board of the National Bank №22 dated on 02.03.2021 "On approval of the list, forms, deadlines for Reporting by branches of non-resident Banks of the Republic of Kazakhstan and the Rules for its submission." • Resolution of the Board of the National Bank №23 dated on 02.03.2021 "On approval of the list, forms, deadlines for reporting on the implementation of
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	<p>prudential standards by branches of non-resident banks of the Republic of Kazakhstan (including branches of Islamic non-resident banks of the Republic of Kazakhstan) and the Rules for its submission."</p> <ul style="list-style-type: none"> Resolution of the Board of the National Bank №107 dated on 21.09.2020 "On approval of the Rules for reporting on accounting data by branches of non-resident banks of the Republic of Kazakhstan, branches of insurance (reinsurance) organizations-non-residents of the Republic of Kazakhstan, branches of insurance brokers-non-residents of the Republic of Kazakhstan." <p>The list, forms of financial and other reporting of banks, including the financial and other reporting on a consolidated basis, terms and procedure for its submission to the NBK are established by the following regulatory legal acts of the NBK in coordination with the authorized body:</p> <ul style="list-style-type: none"> Resolution of the Board of the NBK No. 315, "On approval of the list, forms, reporting deadlines of large participants of banks, bank holdings, large participants of insurance (reinsurance) organizations, insurance holdings, large participants of the investment portfolio manager, second-tier banks and the Rules for their submission." Resolution of the Board of the NBK No. 258, "On the establishment of a list, Forms, Deadlines for Reporting on the Implementation of Prudential Standards by Banking Conglomerates and the Rules for its submission." <p>At the prior assessment, it was noted that disclosure rules do not require reporting of information related to risk management strategy, governance, or remuneration. These deficiencies have not yet been addressed. It is recommended that relevant regulations and rules be amended to require disclosures about these topics.</p>
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	There are no legal requirements for the bank's obligation to disclose information about all material entities in the group structure
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	<p>According to Agency staff, the statutory requirements for the publication of annual financial statements (consolidated and separate) and the main financial indicators (quarterly) are verified by the Agency. Evaluations by other government agencies are not specified.</p> <p>The banks are obliged to inform the Agency about the publication of reports.</p> <p>In case of violation of the publication deadlines, the banks are subject to supervisory response measures.</p>
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	Information about banks is regularly published on the websites of the Agency and the National Bank.

	<p>The Agency's website contains the following publicly available information:</p> <ul style="list-style-type: none"> • current state of the banking sector. • Key risks identified based on the results of the annual SREP assessment. • results of the AQR and SST conducted by the Agency. • the main priorities of the supervisory policy. <p>In accordance with NBL Law Art of 8, the NBK forms and distributes statistical information on the financial market review, monetary statistics and financial market statistics, balance of payments, international investment position and external debt, participates in the development of forward-looking estimates of the balance of payments.</p> <p>On a monthly/quarterly basis, the following information on banks and banking groups are published on the official Internet resource of the NBK:</p> <ul style="list-style-type: none"> • total balance sheet of tier two banks. • total statement on income and expenses of tier two banks. • information about owned capital, liabilities and assets. • information on average interest margin and average interest spread. • balance and off-balance sheet account balances. • compliance report on compliance with prudential normative requirements. • information on the liquidity. • information on the structure and quality of the loan portfolio. • information on the structure of deposits. • information on the funding structure. • information about main indicators of banking groups. • concentration of assets of banking groups. • compliance with prudential standards by bank groups. • measures of influence and sanctions applied against banks for violation of deadlines of submission of financial or other statements. <p>In accordance with the Decree of the Government of the Republic of Kazakhstan No. 774, "On approval of the unified list of open data of state bodies posted on the Open Data Internet Portal," a consolidated balance sheet and a consolidated report on income and expenses for second-tier banks are posted on the open data portal on a monthly basis.</p>
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	
Assessment of Principle 28	Largely Compliant

Comments	<p>Supervisory authorities have adopted regulations and rules that require banks to disclose regularly information on consolidated or solo basis that is easily accessible. The regulations seek to ensure that the disclosures reflect fairly the bank's or the banking groups' financial condition, performance, and risk exposures.</p> <p>One important exception with international standards is that laws and regulations do not require the disclosure of all material entities within a corporate group structure. This may undermine the presentation of a truly consolidated banking group and reduce the market's insight into the condition of the consolidated banking group. Supervisors should amend the relevant regulations or rules to require the disclosure of all material entities that exist within a group.</p> <p>Similarly, as relevant laws and regulations do not require the reporting of risk management strategy, governance, or remuneration, the authorities are encouraged to adopt such requirements in line with Basel Core Principle requirements.</p>
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁷⁶
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>According to Law 474-II Art. 15-2, par. 1, the control and supervision body within its competence carries out independently or with the involvement of other state bodies and (or) organizations checks based on the risk assessment, unplanned and documentary checks of the activities of audited entities in a comprehensive or selective way on specific issues of their activities.</p> <p>According to Law 474-II Art. 9, clause 2-1 , the Agency within its competence carries out the control and supervision of observance by the financial organizations, branches of non-resident banks, branches of non-resident insurance (reinsurance) organizations, branches of non-resident insurance brokers, National Operator of Post of the requirements of the legislation of the Republic of Kazakhstan about counteraction to legalization (laundering) of illegally gained income and financing of terrorism.</p> <p>The legal foundations of anti-money laundering (legalization of proceeds of criminal activity) and countering the financing of terrorism, the legal relations between financial monitoring units, the authorized agency, and other government agencies in the sphere of anti-money laundering (legalization of proceeds of criminal activity) and countering the financing of terrorism, as well as implementation mechanisms for targeted financial sanctions related to the prevention of terrorism and the financing of terrorism and the prevention, prohibition, and termination of proliferation of weapons of mass destruction and its financing, are established in the Law on</p>

⁷⁶ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	<p>Counteraction of Legitimization (Laundering) of Incomes Received by Illegal Means, and Financing of Terrorism (hereafter Law on AML/CFT).</p> <p>Under the Law on AML, the Agency is responsible for developing the relevant regulations for conducting risk assessments of AML (Article 11-1.2). The agency is furthermore authorized to take measures to counteract money laundering and the financing of terrorism and to ensure compliance with relevant rules among individuals and legal entities. (Law on AML/CTF, 17-1; 17-2).</p> <p>Resolution No. 18 of the Board of the Agency dated March 22, 2020, established Requirements for Internal Controls for the Purposes of Anti Money Laundering (Legalization of Proceeds of Criminal Activity) and Countering the Financing of Terrorism for Second-Tier Banks, Branches of Non-Resident Banks of the Republic of Kazakhstan, and the National Post Operator (hereafter, "Agency Requirements for Internal Controls for AML").</p> <p>Order No. 13 of the Chairman of the Financial Monitoring Agency of the Republic of Kazakhstan dated February 22, 2022, approved the Rules for the Provision of Information by Financial Monitoring Units on Operations Subject to Financial Monitoring and Characteristics of Suspicious Operations.</p> <p>Requirements for risk management and internal controls for second-tier banks, including those applying to the development, implementation, and ensuring the presence of internal controls for the purposes of AML/CFT, were approved by Resolution No. 188 of the Board of the National Bank dated November 12, 2019, "On Approval of Rules of Establishing Risk Management Systems and Internal Controls for Second-Tier Banks and Branches of Non-Resident Banks of the Republic of Kazakhstan."</p> <p>Customer due diligence is performed by financial monitoring units in accordance with article 5 of the Law on AML/CFT.</p> <p>In addition, Resolution No. 140 of the Board of the National Bank dated June 29, 2018, approved requirements for customer due diligence in cases where financial monitoring units establish business relations remotely.</p>
EC2	<p>The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>The Agency's Supervisory Department analyzes a bank's AML/CFT compliance activities, which includes the analysis and study of</p> <ol style="list-style-type: none"> 1) internal documents, including internal control rules. 2) recent reports and (or) recommendations of the internal audit and compliance control units of the banks on AML/CFT issues based on the results of inspections. 3) measures on current and future products that are necessary to comply with the AML/CFT legislation of the Republic of Kazakhstan. <p>This work is meant to help the Agency identify deficiencies in banks' policies and processes that might endanger their compliance with the AML/CFT law, to exercise supervisory judgments where necessary, and to direct banks to take appropriate</p>

	<p>measures to eliminate the relevant deficiencies. However, the Agency clarified that it never exerted 'motivated judgement' on banks' AML risk management.</p> <p>When the Supervisory Department identifies incidents of non-compliance with the Law on AML/CFT, it requires banks to provide explanations with supporting documents, and, if necessary, to initiate a review of relevant documentation.</p> <p>If the results of the review confirm a violation of the Law on AML/CFT, the Supervisory Department considers the appropriate supervisory measures to apply.</p> <p>NBK Reg. 188 sets requirements for banks' risk management systems and controls and requires, among other responsibilities, that banks must mitigate the risk of money laundering and the financing of terrorism. As part of its risk-based approach, the Agency employs an annual supervisory process based on the SREP methodology, which includes an evaluation of the banks' exposure to money laundering and terrorist financing risks and their compliance with the relevant laws and rules on AML/CFT.</p> <p>Interviews with Agency staff suggest that curators as well as staff from the Supervision Department, the Regulation Department, and the Methodology Department are the most active in ensuring and conducting oversight of banks' compliance with AML/CFT-related laws and regulations. Six staff from the Methodology Department are involved in developing and maintaining the Agency's approaches to AML/CFT. An additional 14 staff from the Banking Regulation Department conduct offsite supervision of AML/CFT matters, while 20 from the same department conduct onsite inspections of banks' AML/CFT risk management frameworks. One Agency staff member holds the internationally recognized Certified Anti-Money Laundering Specialist designation, while three hold what the staff described as a Kazakhstani AML/CFT certificate. Management and staff confirmed that the Agency provides regular training on AML/CFT-related matters.</p> <p>AML/CFT-related reviews are included in regular inspections conducted as part of the Agency's SREP inspections. Staff may also undertake special onsite reviews, including unannounced inspections, when the Agency identifies or learns of concerns in this area, such as when the Agency receives intelligence concerning a particular customer or transaction that may be suspicious from a foreign regulator or another domestic authority.</p> <p>According to staff, onsite inspections can include an evaluation of the bank's customer due diligence (CDD) processes as well as an evaluation of the bank's transaction monitoring processes. Please see the assessments of EC3 and EC5 for more details on how the Agency conducts its oversight of these processes.</p> <p>Assessors reviewed two examples of reports of inspection related to Core Principle 29. The intensity of the work for the Agency's staff was evident in one case in which a bank with a high degree of money laundering risk required six staff members and three months to review.</p>
EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents</p>

	of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. ⁷⁷
Description and findings re EC3	<p>Article 10-2 of the Law on AML/CFT requires banks to submit information to the Agency about transactions subject to financial monitoring, which should include information about the participants in the transaction and the grounds for considering the transaction to be suspicious.</p> <p>To undertake this reporting requirement, banks are required to appoint a “responsible employee.” According to the Agency Requirements for Internal Controls for AML, the bank shall appoint a responsible person (hereinafter - responsible employee) from among management of the bank, in the manner prescribed by the internal documents of the bank, responsible for implementation of and compliance with internal control rules in the bank.</p> <p>The requirements for the responsible employee are as follows:</p> <ol style="list-style-type: none"> 1) higher education. 2) work experience as manager of bank division related to performance of banking and (or) other operations for at least 1 (one) year or work experience in AML/CFT sphere for at least 2 (two) years or work experience in the sphere of rendering and (or) regulation of financial services for at least 3 (three) years. 3) Impeccable business reputation in accordance with the Banking Law. <p>The functions of the responsible employee and employees of AML/CFT unit in accordance with the internal control organization program for AML/CFT purposes include—but are not limited to—the following:</p> <ol style="list-style-type: none"> 1) ensuring availability of internal control rules and (or) amendments (additions) to them developed and agreed with the management body or executive body of the bank, as well as monitoring of their compliance in the bank. 2) organization and control of submission of reports to the authorized body on financial monitoring in accordance with the Law on AML/CFT. 3) making decisions on recognition of operations of customers as suspicious and the need to send notifications to the financial monitoring authority in accordance with the procedure prescribed by the internal documents of the bank. 4) informing the bank management body and (or) executive body of the bank on revealed violations of internal control rules in accordance with procedures prescribed by internal documents of the bank. 5) preparation of information on the results of implementation of internal control rules and recommended measures for improvement of AML/CFT risk management and internal control systems, including within the bank group, for formation of reports to the management body of the bank and executive body on revealed shortcomings. 6) coordination on the collection of quantitative and qualitative indicators to assess the risk of bank's involvement in ML/TF processes and transfer the requested

⁷⁷ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	<p>information to the Agency annually no later than February 5 of the year following the reporting year.</p> <p>According to interviews with Agency staff, all institutions subject to the Agency's supervision are allocated into one of three groups reflecting either a high, medium, or low degree of money laundering or terrorist financing risk. High risk institutions are subject to an annual inspection, while medium and low risk institutions are subject to supervisory review every other year or every third year, respectively.</p> <p>To ensure that institutions are monitoring and appropriately identifying transactions that raise suspicions about money laundering, terrorist financing, or fraud, Agency staff indicated that institutions are required to upload files to the Agency containing a list of all payments and similar transactions undertaken since the prior onsite inspection. This suggests that Agency staff thus have access to as many as three years' worth of transaction data in the case of low-risk institutions or one year's worth of transactions for high-risk institutions. Agency staff report that one year of activity for a bank of average risk yields approximately 128 thousand transactions.</p> <p>According to Agency staff, those responsible for evaluating those transactions rely on spreadsheets or free tools to comb through the extensive payments data that the firms have provided to spot suspicious transactions. With this information in hand, Agency staff reported that they can then compare the transactions they have spotted with those flagged by the institutions' staff as suspicious. The Agency applies this intensive methodology at all onsite inspections regardless of a bank's risk profile.</p>
EC4	<p>If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.</p>
Description and findings re EC4	<p>The AML/CFT legislation provides for the obligation of other state bodies, including the Agency, to send information on suspicious transactions to the Agency for Financial Monitoring. Thus, according to paragraph 2 of Article 18 of the AML/CFT Law, the state bodies of the Republic of Kazakhstan are obliged to inform the authorized body about</p> <ul style="list-style-type: none"> • suspicious transactions; or • violations of the AML/CFT Law by the subjects of financial monitoring.
EC5	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ol style="list-style-type: none"> (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence programme on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant;

	<p>(c) policies and processes to monitor and recognize unusual or potentially suspicious transactions;</p> <p>(d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);</p> <p>(e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons) and</p> <p>(f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.</p>
Description and findings re EC5	<p>In light of the extensive information shared by Agency staff, the description of EC 5 is broken up into two segments, namely (1) Legal and Regulatory Requirements and (2) Supervisory Activities.</p> <p>Legal and Regulatory Requirements</p> <p>In accordance with clause 4 of Article 5 of the AML/CFT Law, the due diligence by the subjects of financial monitoring (second-tier banks) of their clients (their representatives) and beneficial owners shall be carried out in accordance with the Agency Requirements for Internal Controls for AML.</p> <p>According to item 3-2 of article 11 of the Law on AML/CFT, the requirements for combating the legalization (laundering) of proceeds of crime, terrorist financing and financing of proliferation of weapon of mass destruction are established by the Agency for second tier banks.</p> <p>The legislation specifies that banks must develop internal controls that are adopted by the board of directors and senior management to undertake financial monitoring, considering the degree of the institution's exposure to the risks of legalization (laundering) of income and terrorism financing; and the size, character and complexity of the institution. As specified in the Law on AML/CFT, banks must adopt a monitoring program that includes the following elements:</p> <ul style="list-style-type: none"> • A program of internal control organization for anti-money laundering, counter-terrorism financing and proliferation financing; • a risk management program (low, high risk) for money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction, taking into account the risks of clients and risks of use of services for criminal purposes, including the risk inherent in the use of advanced technology; • a customer identification and due diligence program; • a program for monitoring and examining client transactions, including examining complex, unusually large and other unusual transactions of clients; • A training and education program for subjects of financial monitoring in the field of combating money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction; and • Other programs that can be developed by the subjects of financial monitoring in accordance with the rules of internal control.

In accordance with clause 22 of the Agency Requirements for Internal Controls for AML, the identification and due diligence program for clients, their representatives, and beneficiary owners includes, but is not limited to, the following:

- 1) the procedure for accepting clients for servicing, including the procedures, grounds for and terms of the bank's decision to refuse to establish a business relationship and (or) to conduct a transaction, as well as termination of the business relationship.
- 2) the procedures for identifying and conducting due diligence of the client (or its representative) and the beneficial owner, including the requirements for the application of simplified and enhanced customer due diligence measures.
- 3) the requirements for due diligence when establishing the correspondent relationships with foreign financial institutions.
- 4) the description of measures to identify and conduct due diligence on customers (their representatives); beneficial owners; public officials, their spouses, and close relatives being serviced or accepted for servicing.
- 5) procedures for addressing targeted financial sanctions and for the verification of clients (their representatives) and beneficial owners against the list of organizations and persons connected with terrorism and extremism financing or the financing weapons of mass destruction and proliferation, drawn up in accordance with Articles 12 (hereinafter—the List) and 12-1 (hereinafter—the FFMS list) of the AML/CFT Law.
- 6) The procedure for the termination of targeted financial sanctions when information on the client (its representative) and the beneficial owner is excluded from the List and the FROMU List.
- 7) requirements for identification and customer due diligence when establishing business relationships remotely (e.g., without the personal presence of the Client or his/her representative).
- 8) requirements regarding the exchange of information obtained during the identification and customer due diligence of the client (its representative) and the beneficial owner, as well as the storage and confidentiality of such information as part of the AML/CFT requirements established by the banking group, which includes the bank (if any).
- 9) requirements regarding the identification and due diligence for customers when obtaining information from other financial institutions, including identification of individuals and legal entities for the benefit or on behalf of which the broker (dealer) performs transactions on its bank account.
- 10) procedures for verification of the authenticity of information about the client (its representative) and beneficial owner.
- 11) requirements for the form, content, and procedure for maintaining the client file, updating information contained in the file, with an indication of the periodicity for updating information.
- 12) procedures to assess the risk level of the customer and the grounds for such risk assessment.
- 13) procedures for obtaining and submitting information on beneficial owners of customers at the request of the bank in the form and manner determined by

	<p>the financial monitoring authority, in accordance with paragraphs three and four of item 5 of Article 5 of the AML/CFT Law.</p> <p>With regard to the definition of the “beneficial owner,” the AML/CFT law describes a beneficiary owner as “an individual to whom more than twenty-five percent of partnership shares in a charter capital belong (sic) directly or indirectly or allotted (the deduction of privileged and repurchased by society) of shared of a client legal entity; carrying out a control over the client by other methods; in whose interests the client commits transactions with money and (or) other property.” (AML/CFT Law Article 1.3).</p> <p>With regard to public officials referred to in paragraphs six, seven and eight of subparagraph 3-2) of Article 1 of the AML/CFT Law, their spouses and close relatives, institutions must:</p> <ol style="list-style-type: none"> 1) conduct an assessment of the public official’s reputation with respect to his or her involvement in AML/CFT-related cases. 2) obtain the written permission of the bank’s managerial staff to establish and continue the business relationship with such customers (their representatives) and beneficial owners. 3) establish the source of funds and (or) other property of such customers (their representatives) and beneficial owners. 4) take enhanced due diligence measures for such clients (their representatives) and beneficial owners on an ongoing basis. <p>With regard to the public officials mentioned in the second, third, fourth and fifth sub-item 3-2) of item 1 of the AML/CFT Law, their spouses and close relatives, such clients must be assigned a high-risk level. The bank, in addition to the measures mentioned in item 3 of item 5 of the AML/CFT Law, shall also apply the measures mentioned in sub-items 1), 2), 3) and 4) of part three of this item.</p> <p>Information received in accordance with Items 23 and 24 of the Requirements within the framework of identification and due diligence of the client (its representative) and beneficiary owner shall be documented and recorded and included by the bank in the client’s file, which must be kept by the bank during the whole period of business relations with the client and not less than 5 (five) years after termination of business relations with the client or execution of a one-time operation (transaction).</p> <p>Information obtained under implementation of the program for monitoring and examination of customer transactions shall be entered in the customer file specified in paragraph 25 of the Requirements and (or) kept by the Bank for the entire period of business relations with the customer and not less than five (5) years after execution of a transaction or execution of a one-time transaction (deal).</p> <p>Notices of transactions specified in Part one of this Clause, as well as the results of their examination, shall be kept by the Bank for at least five years after the transaction.</p> <p>Supervisory Activities</p> <p>As noted earlier in this assessment, Agency staff may conduct onsite inspections and review of supervised institutions’ approaches to the handling of customer due diligence requirements. In this regard, staff described extensive efforts to evaluate newly onboarded customers since the prior supervisory review, as explained below.</p>
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	<p>Agency staff report that when inspectors or other staff visit a bank or other supervised entity to evaluate customer due diligence requirements, they typically seek to verify that the bank has properly adhered to all requirements for any new customers onboarded since the prior visit. In some cases, this can mean evaluating 3,000 to 5,000 new customer files, a task that Agency staff indicate can take two inspectors one to up to three months to complete. In most cases, Agency staff are reviewing electronic records and files containing the information on new customers.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	<p>According to article 9 of the Law on AML/CFT, banks and others subject to financial monitoring requirements specified in sub-item 1) of item 1 of article 3 of the present Law, are required to undertake the following steps when establishing correspondent relations with foreign financial organizations (in addition to carrying out the measures provided by item 3 of article 5 of the present Law):</p> <ul style="list-style-type: none"> 1) on the basis of publicly available information, collect and document information on the reputation and nature of activities of the respondent foreign financial organization, including the investigation and application of any sanctions against it for violation of the legislation of the country of its registration on combating the legalization (laundering) of proceeds of crime and terrorist financing. 2) document information on internal control measures taken by the respondent foreign financial organization in accordance with the legislation of the country of its registration on combating legalization (laundering) of proceeds of crime and terrorist financing, as well as assess efficiency of internal control measures taken. 2-1) obtain confirmation that the correspondent foreign financial institution has conducted due diligence of the customer that has direct access to accounts of the correspondent bank and that it can provide the required information on customer due diligence upon request of the correspondent bank. 3) take steps to prevent the establishment and maintenance of correspondent relationships with shell banks. 4) ensure that the respondent foreign financial institution denies the use of its accounts by shell banks. 5) obtain permission from the entity's executive officer to establish new correspondent relationships. <p>Evaluations of compliance with AML-related laws and regulations form part of the onsite supervisory process, including the regular SREP examinations of relevant banks.</p>

	Establishing correspondent relations with shell banks shall be determined on the basis of information provided by the respondent foreign financial institution and (or) received by the bank or other supervised entity from other sources.
EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	The supervisory authority assesses the extent to which banks are exposed to money laundering and terrorist financing risks and the banks' compliance with the requirements of the AML/CFT Law. Supervisory activities related to these requirements are discussed above in the description of EC 3 and EC 5.
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	<p>The Supervisory Department, upon discovering violations and (or) non-compliance by banks with the requirements of the AML/CFT Law, requires explanations with supporting documents, and, if necessary, opens a documentary inspection.</p> <p>Article 17 of the AML/CFT Law outlines rights and obligations of the Agency in this regard, which includes (1) requesting information from supervised entities (17.1.1); (2) suspending suspicious transactions for up to three working days (17.1.2); and (3) take measures in response to money laundering or terrorist financing (17.2.1).</p> <p>Based on the results of the study of the materials received, the Supervisory Department, if it is confirmed that there has been a violation and (or) a failure to comply with the AML/CFT Law, initiates the issue of applying supervisory measures or sanctions.</p>
EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts⁷⁸ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship, and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	<p>Since the prior FSAP, an important reform has included the requirement for banks to identify a specific AML-related compliance officer (called "the responsible employee" or "responsible officer").</p> <p>According to paragraph 11 of the Agency Requirements for Internal Controls for AML, the functions of the responsible officer, employees of the AML/CFT unit, as well as employees of the bank with the functions specified in paragraph 8 of the Requirements shall not be combined with the functions of the internal audit service,</p>

⁷⁸ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>as well as the functions of departments engaged in the operational (day-to-day) activities of the bank.</p> <p>As part of organization of internal control for AML/CFT purposes, the management or executive body of the bank shall develop and adopt internal control rules, including requirements for the internal audit service of the bank to assess the effectiveness of internal control for AML/CFT purposes. The internal control rules shall be executed by the bank taking into account the results of assessment of the degree of exposure of the bank's services to ML/TF risks, size, nature and complexity of the bank.</p> <p>In accordance with paragraph 7 of the Requirements to Internal Control Rules the Internal Control Program for AML/CFT purposes shall include the procedure for preparation and submission to the management body and the executive body of the bank of management reports, including on a consolidated basis within the banking group, based on the results of the AML/CFT internal control efficiency assessment by the internal audit service of the bank.</p> <p>Paragraph 5 of the Agency Requirements for Internal Controls for AML stipulates that in accordance with the procedure established by the internal documents of the bank, the bank shall appoint a person responsible for the implementation of and compliance with internal control regulations in the bank (hereinafter—the responsible employee) from among the bank's executives or other bank managers not below the level of head of the relevant structural unit of the bank, and identify employees or a bank unit whose competence includes AML/CFT issues (hereinafter - the AML/CFT unit).</p> <p>The AML/CFT internal control organization program shall include a description of AML/CFT division functions, including the procedure for interaction with other divisions of the bank, branches, subsidiaries when implementing AML/CFT internal control, as well as functions, powers of the responsible employee, the procedure for interaction of the responsible employee with the management body and executive body of the bank.</p> <p>According to clauses 8 and 9 of the Agency Requirements for Internal Controls for AML, the functions of the responsible employee and employees of AML/CFT subdivision in accordance with the internal control organization program for AML/CFT purposes include, but are not limited to:</p> <ol style="list-style-type: none"> 1) ensuring the availability of internal control rules and (or) amendments (supplements) thereto developed and agreed with the management body or executive body of the bank, as well as monitoring of compliance therewith in the bank. 2) organization and control of submission of notifications to the authorized body on financial monitoring in accordance with the AML/CFT Law. 3) making decisions on recognition of operations of customers as suspicious and the need to send notifications to the financial monitoring authority in accordance with the procedure prescribed by the internal documents of the bank. 4) informing the management body of the bank and (or) the executive body of the bank on revealed violations of internal control rules in accordance with the procedure prescribed by the internal documents of the bank.
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	<p>5) preparation of information on the results of implementation of internal control rules and recommended measures to improve AML/CFT risk management and internal control systems, including within the banking group, to form reports to the management body of the bank and the executive body on the identified deficiencies.</p> <p>6) coordination of collection of quantitative and qualitative indicators for assessment of risk of bank's involvement in AML/CFT processes and submission of requested information to the authorized body on regulation, control and supervision of financial market and financial organizations (hereinafter - the authorized body) annually no later than February 5 of the year following the reporting year.</p> <p>In order to perform the assigned functions, the AML/CFT unit officer and employees shall be vested with the following powers, including, but not limited to:</p> <ol style="list-style-type: none"> 1) obtaining access to all bank premises, information systems, means of telecommunication, documents and files within the limits that allow carrying out their functions to the full extent and in the manner prescribed by the internal documents of the bank. 2) sending instructions to bank divisions regarding performance of operation with money and/or other property. 3) ensuring confidentiality of information received during performance of its functions. 4) ensuring safety of documents and files received from bank departments. <p>In accordance with Chapter 6 of the Agency Requirements for Internal Controls for AML, the purpose of the AML/CFT Training and Education Program (hereinafter—the Training Program) is to provide bank employees with knowledge and skills necessary for their compliance with AML/CFT legislation, internal control rules and other internal documents of the bank in the AML/CFT sphere.</p> <p>The Training Program shall be developed in accordance with the requirements for AML/CFT training and education of financial monitoring entities specified in paragraph 8 of Article 11 of the AML/CFT Law. In interviews, Agency management and staff noted the frequent offering of training on AML/CFT-related issues, though no specific number of days of training are mandated each year. In addition, it should be noted that at present, no Agency staff hold international AML/CFT professional certificates or related certifications.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management, and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings re EC10	<p>According to clause 13-2 of the AML/CFT law, second-tier banks, branches of non-resident banks of the Republic of Kazakhstan, and the National Post Operator must adopt a program of internal controls for AML/CFT purposes that includes, but is not limited to the following:</p>

	<ol style="list-style-type: none"> 1. the procedure for recording information, as well as storage of documents and information obtained in the course of the implementation of internal controls for AML/CFT purposes. 2. procedures for informing the management and executive body of the institution, including the responsible employee (AML officer), about any violations of the Law on AML/CFT and internal control rules by the bank's employees. 3. a description of AML/CFT requirements of the banking group, which includes the bank (if any). 4. procedures for the preparation and submission to the management body and executive body of the bank of management reports, including on a consolidated basis within the banking group, based on the results of AML/CFT internal controls assessment by the bank's internal audit function. 5. procedures of decision-making by the responsible officer, management body and (or) executive body of the bank or managerial staff of the bank on the establishment, continuation or termination of business relations with customers; the suspension or refusal to perform transactions for customers in cases related to the Law on AML/CFT and (or) agreements with customers and in accordance with the procedure stipulated by internal documents of the bank. 6. procedures for assessing, determining, documenting, and updating the results of ML/TF risk assessment. 7. descriptions of AML/CFT subdivision functions, including procedures for interacting with other subdivisions of the bank, branches, and subsidiaries when implementing internal controls for AML/CFT purposes; as well as the functions and powers of the responsible employee, and the procedures for the responsible employee to interact with the management body and executive body of the bank. 8. The procedures for the observance and implementation of internal control rules, including the procedures for applying additional control measures, and procedures for ML/TF risk management and mitigation by its branches, representative offices, subsidiaries located both in the Republic of Kazakhstan and abroad, assuming that such rules to not contradict the legislation of the host state of those operations. <p>Our assessment of EC 3 includes a summary of how the ARDFM conducts its onsite supervision of these functions.</p>
EC11	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	As part of the requirements of the AML/CFT Law, the Methodology for assessing ML/TF risks and the Rules, the responsibility for providing information on suspicious transactions lies with the bank. According to Article 11 of the AML/CFT law, "In the event that information, data, and documents are provided to the authorized body in accordance with this Law, the subjects of financial monitoring, their employees, and officials, regardless of the results of notification, shall not be liable under the laws of the Republic of Kazakhstan, as well as a civil law contract."
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information

	related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	As part of the requirements of the AML/CFT Law, as well as on the basis of agreements and memorandums, there is a possibility to exchange information. Assessors discussed the approach to sharing information with the relevant domestic authorities, such as the financial intelligence unit, and found these approaches to be adequate. Joint inspections are sometimes conducted with the financial intelligence unit (the Financial Monitoring Agency), for example. As described elsewhere in this report, the assessors have seen little evidence of substantial coordination with foreign supervisory authorities on a variety of topics, though we understand the ARDFM has responded to requests for information on AML/CFT related investigations abroad.
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	The Financial Monitoring Agency of the Republic of Kazakhstan conducts efforts to counter the laundering of illegally-gained income and terrorism financing, and also on prevention, revealing, suppression, disclosing and investigation of economic and financial offenses. This includes offering guidance to banks on emerging risks and typologies regarding AML/CFT. Within the Agency, the inspection team that evaluates banks' AML/CFT risk management is also responsible for supervising other specialized risks, including crypto asset supervision, fraud, and sanctions.
Assessment of Principle 29	Largely Compliant
Comments	<p>The Agency has adopted an ambitious approach to implement and enforce the existing legislation and regulations, many of which have been amended significantly to address many of the deficiencies identified at the prior Basel Core Principles Assessment. In particular, improvements are noted in the introduction of a definition for beneficial owner; a strengthening of customer due diligence requirements, including coverage of both foreign and domestic politically exposed persons; the requirement for banks to identify a specific AML-related compliance officer (the responsible employee); and prohibitions on forming correspondent relationships with shell banks.</p> <p>Nonetheless, the Agency's approach to onsite inspections appears to lack a risk-focused approach. Its extensive efforts to review all customer documentation and to evaluate every transaction a supervised institution has undertaken reflects an understanding of the importance of ensuring an appropriate risk management framework for banks. Nonetheless, it shifts the responsibility for identifying risks associated with money laundering and terrorist financing from the firms to the Agency. The approach sets a high cost in terms of time and resources for the Agency, potentially diminishes its ability to spot problems, and potentially exposes the Agency to legal and reputational risks.</p> <p>Under a risk-focused approach, a supervisor should evaluate the appropriateness of a bank's policies and procedures and evaluate the implementation of the bank's own internal mechanisms for conducting customer due diligence and monitoring and reporting on suspicious transactions. This would include reviewing internal audit reports on the same. A risk-focused approach can include direct testing of typically a limited number of customer due diligence files and transactions but normally would not seek to replicate the totality of a bank's AML risk management practices. It is</p>

	<p>reasonable to ask whether the Agency's efforts to evaluate a large number of customer files and transactions during periodic inspections with limited staffing, technology, and time is effective.</p> <p>We encourage the Agency to continue to invest in its staffing and technology for AML/CFT, including potentially procuring appropriate tools for conducting evaluations of customers and transactions when necessary. Here it should be noted that the Agency does recognize the importance of offering Agency staff and management training on AML/CFT issues, which is important to strengthening and building the staff's capacity in this rapidly evolving field. The Agency should additionally consider encouraging key managers and staff to seek internationally recognized professional certificates in AML/CFT as a means of ensuring that its staff is well prepared to evaluate banks' practices and staff in the field.</p> <p>Finally, given the wide range of responsibilities assigned to the team covering AML/CFT, it may be useful to establish specialized teams for the most significant topics beyond AML/CFT, such as fraud, sanctions, crypto-related activities, and so on.</p>
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SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	<p>The safety and soundness of banks and banking system is not prioritized over other mandates in the law. While a promotional mandate is not uncommon to emerging markets and developing economies (EMDEs) supervisors, conflicts might arise with the financial stability goal. For example, stimulating the flow of credit to the economy is a KPI of the ARDFM and this could come at the expense of banks' underwriting standards and, ultimately, of the safety and soundness of banks and banking system. Similarly, ARDFM (and NBK) have been tasked with the goal to create an environment for the introduction of innovations, the development of a digital financial infrastructure, and the use of block-chain technology (Concept for market development of the financial sector until 2030). While financial innovation can enhance the resilience of banks (for example, through more efficient and effective internal control systems) it might also create new risks for banks (cyber, crypto –assets, AML/CFT, data privacy, consumer protection etc.) putting pressure on ARDFM at the expense of financial stability, regardless of their potential merits in advancing the public interest. The assessors acknowledge that ARDFM has adopted some institutional arrangements to manage this trade-off: financial inclusion and consumers protection divisions report to the First Deputy Chairman, while banking regulation department report to another Deputy Chairman. Both Deputy Chairmen participate in the Supervisory Committee.</p>

Core Principle	Grade	Comments
2. Independence, accountability, resourcing and legal protection for supervisors	MNC	<ul style="list-style-type: none"> • ARDFM independence is not enshrined in the legislation, but rather undermined by several provisions in the Law 474-II, which makes the ARDFM '<i>directly subordinated</i>' to the President of the Republic of Kazakhstan and confers to him the power to approve the organizational structure and the total staff of ARDFM. • There is a lack of transparency in the process of removal of the governing body, as grounds for removal are not provided by the law. Moreover, there is no duty to publicly disclose the reasons for removal. • One representative from the President of the Republic of Kazakhstan is a member of the ARDFM's Board with voting rights. • The system of financing threatens the ARDFM's autonomy, being ARDFM funded from the republican budget. This impinges on its ability to carry out supervisory functions (for example, hire external experts, carry out appropriate cross border work on-site inspection, supervisory college, develop and maintain its proprietary IT system). • The ARDFM staff is not adequately protected from the cost of defending their actions and/or omissions made while discharging their duties in good faith.
3. Cooperation and collaboration	C	<ul style="list-style-type: none"> • Kazakhstan maintains laws and regulations that provide for collaboration and cooperation between domestic authorities responsible for banking supervision, recognizing the importance of confidentiality. • The involvement of the executive branch in the Financial Stability Council is addressed in Core Principle 1 regarding independence, accountability, resourcing, and legal protection for supervisors. • The ARDFM's engagement with foreign supervisory authorities is assessed in Core Principle 13 regarding home-host relationships.
4. Permissible activities	C	<ul style="list-style-type: none"> • The law defines the term 'bank' and the permissible activities, enabling banks to carry out additional services and securities activities, subject to ARDFM authorization. • The use of the word "bank" and any derivations is limited to licensed banks, whose list is published on the ARDFM website. The taking on of deposits from individuals is reserved to licensed banks, but the taking on of deposit from legal entities does not follow into these reserved activities.
5. Licensing criteria	LC	<ul style="list-style-type: none"> • The ARDFM does not have the power to conduct fit and proper test on the Heads of internal control functions (CRO, Chief Compliance Office, Chief Internal Audit), because they do not fall under the definition of '<i>executive employees</i>' as per art. 20 Banking Law n. 2444.

Core Principle	Grade	Comments
6. Transfer of significant ownership	LC	<ul style="list-style-type: none"> • Relevant laws and regulations define control and significant participation clearly. While the AML/CFT law addresses the concept of a beneficial owner and staff believe it can be used to cover investments, it would be useful to clarify that this term may indeed be used in such circumstances. Nonetheless, notification requirements regarding transfers of significant ownership likely apply to a larger set of owners than the AML definition of beneficial owner because of other definitions set for licensing and changes in ownership. • Finally, laws or regulations should more clearly require banks to notify the ARDFM of any material information that affects the suitability of a major shareholder, such as a major participant or a bank holding company.
7. Major acquisitions	C	<ul style="list-style-type: none"> • The Banking Law gives the ARDFM sufficient authority to approve or reject applications for major acquisitions and to impose prudential conditions on those acquisitions.
8. Supervisory approach	LC	<ul style="list-style-type: none"> • The Agency does not conduct resolvability assessments. • Supervisory discretion is constrained as the '<i>motivated judgment</i>' is limited to the five areas enucleated by the Law. Considering that the risk-based approach is meant to be principle-based, dynamic, and flexible, the limitation could prevent the ARDFM from exerting the needed discretion beyond the cases identified by the law.
9. Supervisory techniques and tools	LC	<ul style="list-style-type: none"> • The ARDFM has not formally assessed the quality, effectiveness, and integration of on-site and on-site functions. • Making the internal, desk-based AQR a regular (annual) exercise can help the Agency focus, in its offsite and (even more) onsite activity, on the banks and portfolios that appear to be more exposed to risks; it can also help in the assessment of granular portfolios, as the small amount of the individual loans requires a super labor-intensive on-site inspection process, with the risk of limiting the credit file review to a negligible percentage of the lending portfolio; however, it must be clear that the internal desk-based AQR is instrumental to the other activities • Stress testing results do not contribute to determination of Pillar 2 capital yet.

Core Principle	Grade	Comments
9. Supervisory techniques and tools	LC	<ul style="list-style-type: none"> • The inspection function is robust, and findings are incisive, even though they are not prioritized (for example, by means of an internal scoring) to give the bank clear recommendations on what need to be corrected in the short-term (urgent) and what could be done in the medium-long term. Moreover, although the Agency representative can decide to attend the board of directors and board committee meetings, the ARDFM does not regularly meet separately with non-independent board members. • There seems to be scope for greater use of horizontal thematic reviews (for example, on corporate governance, cybersecurity, digital financial services, related party transactions, underwriting standards).
10. Supervisory reporting	LC	<ul style="list-style-type: none"> • Supervisory authorities have sufficient power to collect, review, and analyze information and reports from banks and groups. • The ARDFM should strengthen its guidance to banks on how they should validate and verify their estimates of the fair value of assets as well as describe the role of supervisors in evaluating the reliability and prudence of the fair market value estimates. • The ARDFM and the NBK should take stock of existing systems and data and consider ways to strengthen, modernize, or build new platforms to support more effective supervision of the banking sector. This could form part of a new “SupTech” strategy for the two authorities to improve the effectiveness of supervision and make better use of existing data.
11. Corrective and sanctioning powers of supervisors	LC	<ul style="list-style-type: none"> • The ARDFM has a range of supervisory response measures as well as sanctions at its disposal, and assessors discussed examples of their use with ARDFM staff and reviewed documents evidencing their use. • However, the ARDFM exercised forbearance in loosening capital and liquidity requirements in response to the COVID-19 pandemic as well as the outbreak of war in Ukraine. Violations of the liquidity coverage ratio (LCR), net stable NSFR, other liquidity ratios due to outflow of deposits, revaluation of assets and liabilities has been tolerated, subject to banks providing an action plan to address this violation within 9 months. While these are meant to be temporary, the persistence of stressed conditions at global level suggests that the requirements should be restored to their typical levels expeditiously to reduce the potential for risks to expand during this period of uncertainty

Core Principle	Grade	Comments
12. Consolidated supervision	MNC	<ul style="list-style-type: none"> • Risk management and key prudential requirements apply only on a solo level and not on a consolidated level. This deficiency weakens the ARDFM's approach to consolidated supervision. • The ARDFM has self-identified consolidated supervision as an area in which it intends to align its prudential regulation of financial groups with the requirements of the Basel Committee on Banking Supervision. Likewise, it intends to set supervisory and risk management expectations at the consolidated level in accordance with international recommendations. • In particular, the ARDFM should apply prudential standards such as liquidity and capital at the level of e individual company, but not and across the group. ARDFM requirements for risk management are also targeted at individual bank level.
13. Home-host relationships	MNC	<ul style="list-style-type: none"> • Since the ARDFM's founding, it has been passive in its approach to home-host relations, such as in not reviving or establishing any supervisory colleges as the home country supervisor. • While the ARDFM does have a number of MOUs with foreign supervisors, it appears to lack one MOU for the home country supervisor of a significant global bank active in Kazakhstan.
14. Corporate governance	LC	<p>Resolution n. 188/2019 has enhanced the regulatory framework for corporate governance; however, there are still some points of improvement:</p> <ul style="list-style-type: none"> • a requirement for the board to introduce plans for succession is missing. <p>there is no limit to multiple memberships for the members of the board of directors and this could give rise to conflicts of interests (and in some case impinge on the members' time commitment). ARDFM is striving to ensure compliance with the new governance requirements. To that aim, the Agency's representative plays a pivotal role for the assessment of corporate governance arrangements. However, such a supervisory practice is neither complemented by a thematic review on the state of implementation of the mentioned Resolution n. 188/2019 by the banking sector, nor by conducting targeted on-site inspections on corporate governance. FARDFM does not structurally assess banks and banking groups' compensation system</p>
15. Risk management process	LC	<ul style="list-style-type: none"> • There are no legal requirements for banks to prepare recovery plans. • ICAAP and ILAAP not submitted yet by banks at the end of the FSAP mission, which was conducted during the first in-country mission. • Supervisory expectations on ICAAP and ILAAP need to be expanded to entire spectrum of Pillar 2 risk (for example, sovereign, interest rate, and climate related financial risks)

Core Principle	Grade	Comments
16. Capital adequacy	LC	<ul style="list-style-type: none"> • Local RWA for credit risk are in some cases less conservative (exposure to SME, and syndicated loans), but in other more prudent (consumer loans). • The definition of capital is broadly compliant with the applicable Basel standards, with the exception of revaluation reserves (which, however, represent 0.6 percent of total capital). • CCB for no D-SIBs is set at 2 percent instead of 2.5 percent. • No leverage ratio requirement is in place. • Capital requirements do not reflect the banks' risk profile yet: ARDFM has drafted a methodology for Pillar 2 capital add-on, but the roll-out is planned for 2024. The draft methodology covers IRRBB and capital shortfall resulting from under provisioning, but it does not cover other Pillar 2 risks, (for example, sovereign, and climate related financial risk).
17. Credit risk	LC	<ul style="list-style-type: none"> • Despite the tightened capital requirements, the growth rate of consumer lending (about 40 percent in 2021 and 27 percent in 2022) remains a source of concern, due to the lack of clarity on the underlying drivers. During discussion with the mission counterparties, it emerged that some banks are loosening underwriting standards (for example, granting consumer loans to enable borrowers to make the minimum down payment on mortgage loans, or repay overdue debt, including with other financial institutions, or loans to SME owners for financing of their business). • Regulation n. 188/2019 has strengthened the credit risk management framework. However, there is still room for improvement. For example, Regulation 188/2019: <ul style="list-style-type: none"> a) does not cap the maxim amount of a consumer loan in absolute term (and not only in relation to the borrower income) and this might open windows of opportunity for unintended use of consumer loans. b) enables banks to '<i>determine the cases (loans secured by highly liquid assets) in which the analysis of the borrower's creditworthiness is not applied</i>'. Exemptions from credit due diligence requirements should neither be tolerated nor solicited by the regulator (and the availability of the collateral is not an excuse to escape due diligence). c) envisages a threshold for annual assessment of the real estate collateral which is too high (equivalent to US 750k \$) d) is silent on the evaluation method of the collateral.

Core Principle	Grade	Comments
18. Problem assets, provisions, and reserves	MNC	<p>The prudential framework on problem assets and provisioning is not fully aligned with international standards:</p> <ul style="list-style-type: none"> • NPL recognition is limited to 90 days-past-due exposures (currently around 3 per cent of loans as at end 2022), but it does not include IFRS9 stage 3 loans (6.6 percent, at the same date), as well as <i>'unlikely to pay'</i> (UTP) exposures (namely, foreclosed assets). <p>Resolution n. 269 does not set timely write-off requirements of uncollectable loans.</p>
19. Concentration risk and large exposure limits	LC	<ul style="list-style-type: none"> • Regulations require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. • Prudential limits are calibrated to total capital instead of Tier 1. • The definition of <i>'group of connected counterparties'</i> is broad, but quite prescriptive (Resolution n. 170 par. 54) and the ARDFM encounters some limitations to its discretion in applying the definition of <i>'group of connected counterparties'</i> on a case by case, as it lacks the power to exert <i>'motivated judgment'</i>.
20. Transactions with related parties	MNC	<ul style="list-style-type: none"> • While the law provides a broad definition of related party, and the supervisor can exert motivated judgment when recognizing a person as a bank's related party or a transaction as made at <i>'preferential terms'</i>, there is documented evidence that the risk inherent to related party exposures by banks that defaulted between 2020 and 2021, was higher than officially reported, as showed by the on-site inspection reports. • Related party lending has been one of the major drivers of recent bank defaults and on-site examination reports confirmed that abusive related party loans led to extrapolation of private benefits from banks by insiders. • The possibility to transfer distressed assets at non-market terms to subsidiaries acquiring dubious and hopeless assets of the parent bank distorts the correct reflection of credit risk and inflates banks' profits. This practice disincentivizes conservative loan origination and underwriting, as distressed assets can be transferred without a penalty, often even with a premium. It also delays the creation of a NPL secondary market.
21. Country and transfer risks	MNC	<ul style="list-style-type: none"> • Laws and regulations do identify country risk as a risk to be considered and do set requirements for monitoring country risk for AML purposes. • Supervisors nonetheless do not explicitly require the regular reporting of country risk, nor do they set provisioning requirements for country risk.

Core Principle	Grade	Comments
22. Market risk	LC	<ul style="list-style-type: none"> • Overall, supervisory authorities have described a set of requirements for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating market risk on a timely basis. • However, key elements of international standards are still in development or in the process of being implemented in Kazakhstan, in particular the implementation of the ICAAP as well as the imposition of required increases in capital to reflect the results of stress testing. • Models used for valuation of assets are not subject to independent validation. • There are no policies in place for the valuation of positions that are difficult to estimate prudently.
23. Interest rate risk in the banking book	MNC	<ul style="list-style-type: none"> • Supervision of IRRBB is at its infancy stage. While the ARDFM is raising awareness via training, so far this has taken place only at one bank. • Banks were recently requested to quantify their exposure to IRRBB through the two supervisory indicators (EVE and NII); however, such EVE is quantified only in relation to two out of the four scenarios prescribed by the Basel Committee for Banking Supervision. Moreover, ARDFM does not verify this information, due to the lack of a challenger model. • The draft Pillar 2 methodology on IRRBB was recently prepared, but never tested. • ARDFM does not identify outliers.
24. Liquidity risk	LC	<ul style="list-style-type: none"> • Prudential requirements are below the Basel standards (LCR and NSFR requirements at 80 percent). • The violation of LCR, NSFR, and other liquidity ratios, due to outflow of deposits, revaluation of assets and liabilities was temporary tolerated (from February 21, 2022, to December 31, 2022), subject to banks providing an action plan to address this violation within 9 months. • Liquidity requirements do not reflect the risk profile of banks, as they are set at the same level for all banks. • ARDFM does not structurally assess contingency funding plans. • ARDFM assesses liquidity risk during the SREP, but this is partially untested as banks will submit their first ILAAP at the end of the mission. • As 1/3 of deposits is in foreign currency, LCR in tenge does not fully capture currency liquidity mismatches.

Core Principle	Grade	Comments
25. Operational risk	LC	<ul style="list-style-type: none"> • Supervisory authorities have adopted rules and regulations on the adequacy of operational risk management frameworks in banks in Kazakhstan. • However, supervisors have not yet implemented these rules fully, especially the adoption of the basic indicator approach and the ICAAP. • Information technology and cybersecurity represent key sources of operational risk in many banks, yet the ARDFM's resources—especially in cybersecurity—are constrained. It is important for the ARDFM to invest in the training of existing staff and the recruitment of professionals with appropriate skills and expertise to enhance its capacity.
26. Internal control and audit	C	<ul style="list-style-type: none"> • NBK Resolution 188 outlines sufficient guidance to meet the essential criteria for internal controls and internal audit.
27. Financial reporting and external audit	LC	<ul style="list-style-type: none"> • Supervisory authorities have adopted rules and regulations that are broadly aligned with international standards regarding financial reporting and external audit, including correcting some deficiencies noted in the prior assessment related to the rotation of external auditors. • However, the ARDFM is not empowered to reject or rescind the selection of an external auditor that it considers to be inadequate, insufficiently independent, or not aligned with established professional standards. • When supervisors have material concerns about the capability of an external auditor, it is important that they be able to require a bank to hire a more competent auditor to improve confidence in the auditor's findings. Supervisors should also have the power to limit conflicts of interest that may arise when an auditor provides consulting services to the same client as well.
28. Disclosure and transparency	LC	<ul style="list-style-type: none"> • Supervisory authorities have adopted regulations and rules that require banks to disclose regularly information on consolidated or solo basis that is easily accessible and reflect the bank's financial condition, performance, and risk exposures fairly. • One important exception with international standards is that laws and regulations do not require the disclosure of all material entities within a corporate group structure. In addition, laws and regulations still do not require reporting of information related to risk management, strategy, governance, or remuneration. This was cited at the prior FSAP as well.

Core Principle	Grade	Comments
29. Abuse of Financial Services	LC	<ul style="list-style-type: none"> • The ARDFM's approach to onsite inspections appears to lack a risk-focused approach. Its extensive efforts to review all customer documentation and to evaluate every transaction shifts the responsibility for identifying risks associated with money laundering and terrorist financing from the firms to the ARDFM. • The ARDFM relies on free online tools as well as some self-built ones to evaluate risks for AML/CFT in its extensive evaluations of customers and transactions when necessary. • At the time of the mission, the ARDFM employed few managers and staff that had achieved internationally recognized professional certificates in AML/CFT. . • A wide range of responsibilities is assigned to the team covering AML/CFT, including fraud, crypto-related activities, and so on.

RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 1	<ul style="list-style-type: none"> Given the broader responsibilities assigned to the ARDFM, the law should clearly state that any additional mandate is subordinated to the primary objective of the promotion of the safety and soundness of banks and the banking system. Once a hierarchy of objectives is provided by the law, ARDFM should embed the priority of safety and soundness of banks over other mandates in a public document, to make it clear that its decisions will appropriately balance potentially competing objectives and reinforce the motivation for the adoption of consequent institutional arrangements. The ARDFM should eliminate the growth lending rates from its KPI.
Principle 2	<ul style="list-style-type: none"> Law 474-II should be amended to prescribe the ARDFM independence, as well as its autonomy to decide organizational structure and number of staff. The Law should also state that the ARDFM Chair could be removed only if not anymore physically or mentally capable of carrying out the role or found guilty of misconduct. The reasons for removal should be publicly disclosed. The representative from the President of the Republic of Kazakhstan in the ARDFM's Board should not have voting right. The ARDFM may consider building up its own budget—e.g., by levying fees to banks (and other supervised entities) calibrated to their assets or risk weighted assets. The ARDFM should adopt a procedure to protect staff against the cost of defending themselves for actions and/or omissions made while discharging their duties in good faith (choosing a lawyer, representation of interests in court by the legal service, anticipation or reimbursement of legal protection expenses born by the staff, cooperation with the staff involved in the claim filled by third parties, assistance in providing materials and information, etc.).

Principle 3	<ul style="list-style-type: none"> • The involvement of the representative from the President of the Republic of Kazakhstan in the ARDFM's Board is addressed in CP1. • The ARDFM's engagement with foreign supervisory authorities is assessed in CP 13 regarding home-host relationships
Principle 4	
Principle 5	<p>Banking Law should be amended to:</p> <ul style="list-style-type: none"> • enable the ARDFM to carry out the fit and proper test on the Heads of internal control functions. • Set a clear definition of "beneficial ownership" or refer to the AML/CFT Law for the definition of 'beneficial ownership.'
Principle 6	<ul style="list-style-type: none"> • The laws or regulations relevant to investments and acquisitions should define the term "beneficial owner" or should clarify that the definition in the AML/CFT law can be used. • Laws or regulations should more clearly require banks to notify the ARDFM of any material information that affects the suitability of a major shareholder, such as a major participant or a bank holding company.
Principle 7	
Principle 8	<ul style="list-style-type: none"> • The law should be amended to enable motivated judgment to become the ordinary <i>modus operandi</i> of the ARDFM. • In case urgent action is needed (for example, classifying a borrower as related party and preventing a bank from further lending), the ARDFM should be able to adopt a '<i>provisional motivated judgment</i>', giving the person concerned the opportunity to be heard as soon as possible <u>after</u> taking its decision. • The ARDFM might consider establishing an Administrative Board of Review for the purposes of carrying out an internal administrative review of the decisions taken in the exercise of the motivated judgment, after a request for review submitted by any natural or legal person to which the decision is addressed or is of a direct and individual concern to that person. • The ARDFM should conduct resolvability assessment.
Principle 9	<p>ARDFM should consider the following:</p> <ul style="list-style-type: none"> • Regularly assessing the quality, effectiveness, and integration of off-site and on-site function. • For the most important corporate exposures, the desk based AQR could be complemented by ad hoc visits to the bank's office and /or stronger coordination with on-site supervision. • expanding stress testing to climate-related financial risks.

	<ul style="list-style-type: none"> • Strengthening the interaction with non-executive board members • prioritizing the importance of on-site inspections findings and recommendations to banks • a greater use of horizontal thematic reviews (for example, on corporate governance, cybersecurity, digital financial services, underwriting standards, related party transactions).
Principle 10	<ul style="list-style-type: none"> • The ARDFM should strengthen its guidance to banks on how they should validate and verify their estimates of the fair value of assets as well as describe the role of supervisors in evaluating the reliability and prudence of the fair market value estimates. • The ARDFM and the NBK should take stock of existing systems and data and consider ways to strengthen, modernize, or build new platforms to support more effective supervision of the banking sector. This could form part of a new “SupTech” strategy for the two authorities to improve the effectiveness of supervision and make better use of existing data
Principle 11:	<ul style="list-style-type: none"> • While forbearance measures are meant to be temporary, the persistence of stressed conditions at global level suggests that the requirements should be restored to their typical levels expediently to reduce the potential for risks to expand during this period of uncertainty.
Principle 12	<ul style="list-style-type: none"> • The ARDFM should apply prudential standards such as liquidity and capital at the level of both the individual company and on a consolidated level. Likewise, the ARDFM should strengthen its requirements for risk management on a consolidated level.
Principle 13	<ul style="list-style-type: none"> • The ARDFM should revive its supervisory colleges for those Kazakhstani banks that have operations in other jurisdictions. • The ARDFM should ensure that it has established an MOU with the home country supervisor of each significant global bank active in Kazakhstan.
Principle 14	<ul style="list-style-type: none"> • Resolution n. 188 should consider (i) requirements for the board to introduce plans for succession (ii) limits to multiple memberships. • ARDFM should consider (i) conducting a thematic review on the state of implementation by banks of the Resolution n. 188/2019, (ii) scheduling targeted on-site inspections on corporate governance as part of the supervisory examination plan, and (iii) conducting a structured assessment of remuneration policies and practices as well prevent banks which benefitted from state support from paying variable remuneration until the banks reimburses the public support.
Principle 15	<ul style="list-style-type: none"> • The ARDFM should:

	<ul style="list-style-type: none"> • Introduce requirements for banks to prepare recovery plans. • Prioritize ICAAP and ILAAP assessment.
Principle 16	<p>ARDFM to:</p> <ul style="list-style-type: none"> • Phase out the residual Covid-19 capital forbearance measures (align RWA calculation for exposures towards SME and syndicated loans with Basel framework). • Eliminate revaluation reserves from the eligible items in the definition of capital. • Introduce a leverage ratio requirement. • Increase CCB to 2.5 percent also for non- D-SIBs. • Calibrate prudential requirements to risk profile by implementing the draft Pillar 2 methodology. • Expand methodology and Pillar 2 add on to concentration, sovereign risk, and climate related financial risk.
Principle 17	<p>The ARDFM should perform a closer oversight of consumer loan and apply measures to those banks that do not strictly monitor the adequate use of those loans. The ARDFM should also consider amending the framework and</p> <ul style="list-style-type: none"> • cap the maxim amount of a consumer loan in absolute term. • eliminate exceptions to banks' due diligence. • reduce the threshold for annual assessment of the real estate collateral and prescribe the use of more than one methodology.
Principle 18	<ul style="list-style-type: none"> • Expand NPL recognition criteria to IFRS9 stage 3 exposures, as well as foreclosure assets. • Consider timely write off requirements for uncollectable loans.
Principle 19	<ul style="list-style-type: none"> • Calibrate large exposure limits to Tier 1, instead of total capital. • Expand the "motivated judgement" to the "<i>group of connected counterparties</i>" to provide the supervisor with the needed discretion in applying this definition on a case-by-case basis.
Principle 20	<ul style="list-style-type: none"> • The ARDFM should consider an off-site and on-site thematic review on related party transactions, including with the assistance of external experts, to shed light on the size of the phenomenon and prevent insiders from extrapolate private benefits from banks. • Banking Law Art. 40 par. 8 should be revisited and distressed asset transfer by banks to their subsidiaries or organizations specialized in acquiring dubious and hopeless assets should take place at market terms.

Principle 21	<ul style="list-style-type: none"> Supervisors should incorporate into national regulations the necessary requirements for gathering and regularly reporting on country risk; setting and applying provisions against credit exposures to certain countries or geographies; and including country risk as a variable for stress testing.
Principle 22	<ul style="list-style-type: none"> Supervisors should continue to develop and implement fully the requirements for mitigating market risk, including through the full implementation of the ICAAP as well as the imposition of increased capital requirements to reflect the results of stress testing. Supervisory authorities are encouraged to clarify either in NBK Resolution 188 or related rules and regulations that models used for valuation of assets should be subject to independent validation. Moreover, supervisory guidance should require banks to establish policies for the valuation of positions that are difficult to estimate prudently
Principle 23	<p>The ARDFM should:</p> <ul style="list-style-type: none"> require banks to calculate EVE under the six scenarios prescribed by the Basel Committee for Banking Supervision. develop a challenger model to initiate supervisory dialogue with banks on their exposure to IRRBB. identify outliers. roll out the Pillar 2 methodology on IRRBB.
Principle 24	<p>The ARDFM should:</p> <ul style="list-style-type: none"> exit liquidity forbearance measures and set up LCR and NSFR at 100 percent. enforce sanctions in case of violation of prudential liquidity requirement. structurally assess liquidity contingency funding plan. perform a more thorough monitoring of liquidity in foreign currency (including liquidity stress test in foreign currency). Reconsider the weight of liquidity risk in the overall SREP score which seems low (10 percent). test the methodology for assessing ILAAP and, also based on the deficiencies in the liquidity risk management and internal control system, should calibrate liquidity prudential requirements to banks' risk profile. <p>To capture potential currency mismatches, ARDFM could also consider introducing LCR per significant currency, since about 1/3 of deposits is in foreign currency</p>

Principle 25	<ul style="list-style-type: none"> • The ARDFM should fully implement its capital rules for operational risk, including fully adopting the basic indicator approach and the ICAAP. • The ARDFM should invest in the training of existing staff and recruiting professionals with appropriate skills and expertise in cybersecurity, including attaining appropriate internationally recognized professional certifications in cybersecurity and IT risk management.
Principle 26	<ul style="list-style-type: none"> • The ARDFM should consider requiring fit and proper testing for senior leaders involved in internal control functions, such as the chief risk officer, the chief compliance officer, and the internal auditor.
Principle 27	<ul style="list-style-type: none"> • The ARDFM should receive the authority to reject or rescind the selection of an external auditor that it considers to be inadequate, insufficiently independent, or not aligned with established professional standards. • Similarly, the ARDFM should have the authority to set the scope for external audits of supervised banks. It should also require fair value estimates to be subject to independent verification and validation.
Principle 28	<ul style="list-style-type: none"> • Laws or relevant regulations should be amended to require the disclosure of all material entities within a corporate group structure. • In addition, laws or relevant regulations should require disclosures related to risk management strategy, governance, and remuneration.
Principle 29	<ul style="list-style-type: none"> • The ARDFM's approach to onsite inspections of anti-money laundering efforts and countering the financing of terrorism should hold firms accountable for the management of these risks. • The ARDFM should continue to invest in its staffing and technology for AML/CFT supervision, including encouraging staff and managers to attain internationally recognized professional certificates. • The ARDFM should establish dedicated teams to cover significant and specialized risks such as those related to crypto asset activities or fraud. Currently, the team that supervises AML/CFT also handles other risks.

B. Authorities' Response to the Assessment

1. **The authorities of Kazakhstan appreciated the FSAP's assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Kazakhstan.** The authorities also deeply value the professionalism and constructive approach demonstrated by the FSAP team during the assessment. The collaboration between the authorities of Kazakhstan and the assessment team was efficient, leading to the successful completion of the complex project. Authorities highlighted that BCP assessment was beneficial in area of systemic risk analysis, exploring emerging issues, and bringing banking regulation and supervision frameworks in line with international standards.
2. **The Agency and the NBK broadly agreed with the conclusions of the BCP assessment.** The Report highlighted that significant improvements have been made in enhancing supervisory mandate by introducing risk-based supervision based on supervisory review and evaluation process (SREP), stress test and internal desk-based assets quality review (AQR).
3. **By the time the BCP assessment Report was completed the Agency implemented some of the key BCP recommendations.** It is important to note that some of the recommendations, provided in Report, on introduction of consolidated supervision, capital add-ons, Basel Pillar 3 disclosure requirements, and the expansion of motivated judgment were already in implementation stage in realization of the Concept for the Development of the Financial Sector of Kazakhstan, approved by the President in September 2022. There is already tangible progress towards their implementation. BCP assessment and recommendations helped to improve the quality of the new regulatory and legislative changes.
4. **Specifically, since 2022 the Agency has been working on aligning consolidated supervision with Basel standards.** By December 2023, the Agency has developed regulatory legal acts on key prudential standards, risk management and corporate governance systems on a consolidated level. These requirements will be put in place in 2024.
5. **To strengthen capital requirements in accordance with Basel standards,** in December 2023 the Agency introduced regulatory requirements for the capital add-on based on the results of SREP, AQR and supervisory stress testing, and also increased the requirement for the capital conservation buffer to 2.5 percent for non-systemic banks.
6. **The temporary easing of prudential measures for SMEs and syndicated loans exposures, initially introduced to support corporate lending during the Covid-19 pandemic, expired at the end of 2023.** As of January 2024, the risk weights for SME and syndicated loans have been aligned with Basel requirements. Furthermore, starting in January 2024, both the LCR and NSFR requirements increased from 80 percent to 90 percent, with a subsequent rise to 100 percent effective from July 2024.
7. **In relation to resolution of insolvent bank and state intervention framework,** the work on changes to legislation has started in 2023. The Agency requested IMF technical assistance to

develop legislative amendments to improve the efficiency of the insolvent bank resolution mechanism, define the roles and responsibilities of the different stakeholders, specify the forms and mechanism for using public funds and tightening underlying conditions. Moreover, authorities have requested technical assistance on development of playbooks to further operationalize crisis management framework.

8. The Agency takes systemic measures to reduce risks in consumer lending on constant basis, including tightening prudential regulation of consumer loans and Debt Service-to-Income (DSTI) requirement. In November 2023, the Agency proposed to Parliament a draft Law which provides further measures on reducing debt burden and strengthening consumer protection. The draft Law includes BCP recommendations that empower the Agency to cap the maximum amount of a consumer loan. At the regulatory level, in December 2023, all exemptions to DSTI calculation were removed and DSTI requirement was extended on all loans, including secured loans and loans to individuals with high income.

9. The Agency highlighted that the BCP assessment does not sufficiently reflect the progress in enhancing stability of banks and resolving NPL on systemic level which led to underestimation of the grade on the Core Principle 18 «Problem assets and provisioning». While recognizing that the NPL definition needs revision to align with international standards, the Agency highlighted that a large share of problem loans accumulated in previous crises has been resolved and that NPL and Stage 3 loans are declining rapidly. Furthermore, the Agency emphasized that while the NPL definition is confined to 90 days past due exposures, it does not affect the recognition and adequacy of provisioning for stage 3 loans. All banks classify stage 3 loans and provisioning of distressed assets in line with IFRS 9 and Provisioning rules. The NPL90+ level has reached a historical minimum of 3.2 percent. In 2019-2020, international experts conducted an independent asset quality review. Since 2021, the Agency has been consistently evaluating asset quality as part of the regular AQR, and based on the results, banks are required to form additional provisions. Since 2020, the Agency regularly publishes the level of distressed assets in the AQR Report including stage 3 loans, which were at 21.1 percent in 2019, decreased to 14.8 percent in 2022, and further to 13.5 percent in 2023.

10. The Agency took note of the recommendation on related party lending transactions, but we would like to bring attention that such exposures are no longer a systemic issue due to the shift to risk-based supervision and implementation of motivated supervisory judgment. In December 2023, the Agency submitted legislative amendments to Parliament which obliges banks to sell distressed assets to any investor, including to their subsidiaries that acquire distressed assets, exclusively through digital platforms accredited by the Agency at market terms. Participation of other potential investors in these digital auctions will ensure market conditions for the transfer of distressed assets from banks to investors, including banks' subsidiaries. In addition, the Agency plans to conduct a thematic review on related party lending transactions on a regular basis.

11. Regarding the assessment of interest rate risk in banking book (IRRBB), in May 2023 the Agency developed a challenger model for IRRBB to assess the economic value of equity and net interest income based on six scenarios, and integrated it into the SREP-2023. In addition, the Agency

developed operational risk assessment model in accordance with the latest Basel recommendations, which was also incorporated into SREP-2023 assessment.

12. To advance SupTech initiatives, in 2023 the Agency has developed an automated system with modules for analyzing key indicators and risks of banks within the framework of the SREP supervisory model, as well as automated systems using machine learning algorithms to assess suspicious transactions and credit risks. A comprehensive automated system for conducting on-site inspections is also under development.

13. Regarding Agency's dependence on the IT infrastructure of NBK, at present NBK and ARDFM have created a mechanism for financing the Agency's IT projects in the field of supervision at the expense of NBK's own budget. This will expand the Agency's opportunities to independently develop and form a variety of deep analytical representations in line with functional needs. Currently NBK collects, processes, manages all regular reporting data, including granular (e.g., Credit registry) and granted ARDFM access to this data and basic analytics. ARDFM is responsible for deeper analysis of data for supervision purposes. All authorities' mandates and responsibilities in that area are set by Law. All additional regular data collection (not one-time queries) needs legal requirements to be set by ARDFM for market participants. In case of introduction of such requirements, NBK develops its IT-system to collect and manage such data (e.g., recently introduced AML reporting for banks, risk metrics to Credit registry, etc.).

14. To implement recommendations from BCP Report and other FSAP areas, in December 2023 the Financial Stability Council of Kazakhstan approved a Roadmap on implementation of FSAP recommendations. The Roadmap includes a wide range of measures, including adoption of legislative and regulatory changes in 2024–2025.